

Local bus services

The OFT's reasons for making a market investigation reference to the Competition Commission

January 2010

OFT1158

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1 EXECUTIVE SUMMARY

- 1.1 In August 2009 the OFT consulted on the findings from our market study into local bus services. We suggested that the market was not working well and consulted on a proposal to make a Market Investigation Reference to the Competition Commission.
- 1.2 Our market study looked at the extent to which competition in the provision of local bus services in the UK, excluding Northern Ireland (NI) and London, delivers quality and value both for bus users and for the level of public subsidy which the operators receive.
- 1.3 This is a large industry, with recent commercial revenues of approximately £2.4 billion. Local bus services receive a large amount of public funding. In 2006/07 Government support for supported bus services and spending on concessionary fares in the UK, excluding NI and London, amounted to £1.2 billion, which represents almost a third of the total revenue of bus operators.
- 1.4 After consulting on our findings, we remain of the view that the evidence suggests, in many local areas, current competitive pressures may be insufficient to achieve best value outcomes for both bus users and tax payers.
- 1.5 The OFT has decided to make a Market Investigation Reference to the Competition Commission.

Findings

- 1.6 Our evidence indicates that, notwithstanding the constraints which may be placed upon bus operators by cars and other travel options, limited competition between bus operators tends to result in higher prices, our conservative estimate is nine per cent higher, and lower quality, for bus users. The major bus operators commissioned a statistical review of our work which they claim undermines our finding. While we disagree, and believe our results are sound, we consider that the Competition Commission is now best placed to carry out further detailed analysis.
- 1.7 The major bus companies have argued strongly that they face significant constraints from other modes of transport and, in this sense, they argue, they face a great deal of competition. We consider that this argument is

inconsistent with both our analysis and a large number of independent studies. That said, we do acknowledge that there well may be differences in competitive conditions in different local areas. Our analysis did include controls for these differences but of course we expect that the Competition Commission may wish to carry out more detailed work on this point.

- 1.8 In our consultation, we set out evidence which suggested that competition for contracts for supported services may be weak in some local areas and that this may have been a contributing factor to the increase in the cost to the tax payer of providing supported bus services over the last ten years. In particular, we noted that the overall level of bids for contracts was low in many areas and that the total level of support had risen substantially in recent years. We also noted that the cost of like for like services had increased significantly in real terms.
- 1.9 A number of respondents disagreed with the last of these findings arguing that the cost data we had used to calculate the real cost increase in like for like services was flawed. We note that the evidence regarding a low level of bids, combined with the data about the total spending on supported services is, in itself, grounds for concern. We accept that there are issues that make it difficult to precisely estimate the scale of real terms increases in the cost of like for like services, but we continue to believe that the evidence points to potentially significant increases. We also note that a similar finding has been made by other researchers.
- 1.10 Several parties, in response to our consultation, questioned the proportionality of a reference. They argued that current work by Department for Transport, or the available powers to Local Transport Authorities (LTAs), Traffic Commissioners and OFT could adequately deal with the concerns raised in our consultation. They also argued that a reference to the Competition Commission would delay improvements and investment provided for by the Local Transport Act 2008 (LTA 2008).

- 1.11 We disagree that, without further work, the concerns raised in the consultation document can be adequately addressed now. We believe that the Competition Commission is best placed to carry out the necessary further detailed investigation which should reveal the nature of the underlying causes of the problematic features of this market and, if necessary, take an in-depth look at possible remedies.
- 1.12 The OFT has reasonable grounds to suspect that a number of features prevent, restrict or distort competition for local bus services in the UK, excluding London and Northern Ireland and these are summarised below.

Structural features which the OFT reasonably suspects adversely affect competition

- 1.13 The industry has tended to a situation in which many routes, especially non-corridor routes,¹ are served only by a single operator. This may be an inevitable feature of the available demand on these routes and, if so, would not necessarily be a feature adversely affecting competition. In this case, however, given the wider context of regional and local area concentration we suspect that it is such a feature.
- 1.14 Consolidation of depot ownership has meant that large regions tend to become dominated by a particular operator that supplies most of the services. The pattern of depot ownership at a regional level may be a contributing factor to the concentration in service provision at a local level. It may be that regional consolidation in depot ownership makes smaller operators that come up for sale unattractive to any purchaser other than the dominant local operator as they are only a good regional fit for that operator.
- 1.15 The way the concessionary fare regime works may distort the market by creating an incentive for bus operators to raise fares. The concessionary fares regime may, in some areas, give operators an incentive to increase

¹ Corridor routes refer to routes along major road corridors carrying high volumes of traffic, often serving gyratory or radial roads for a town or city.

some commercial fares due to the effect it has on the price sensitivity of the overall customer base and also the effect it can have on their cost base.

Conduct of firms which the OFT reasonably suspects adversely affects competition

- 1.16 We have frequently received allegations of targeted competition of the kind that is designed to eliminate competitors without providing any long term benefit to consumers. We cannot currently say if any of the behaviour has been predatory other than in the two cases we have investigated. Nevertheless, we have reasonable grounds to suspect that this sort of competition, taken in the context that many smaller operators cite it as a key reason for not expanding services into areas where larger operators have services, is conduct that prevents, restricts or distorts competition.
- 1.17 Incumbent bus operators with a well developed network may have little incentive to enter into multi-ticketing arrangements with smaller rivals as the benefits to the rival were greater than the benefits to the incumbent. The OFT considers that it has reasonable grounds to suspect that this is conduct which may prevent, restrict or distort competition.

Conduct of consumers which the OFT reasonably suspects adversely affects competition

- 1.18 Bus users are most likely to get on the first bus that appears at the bus stop going to the destination they want – this has an impact on how bus operators position their services when in competition with each other. This feature may encourage exclusionary behaviour by making 'over-bussing' a particularly effective strategy to deter potential entrants. We consider that consumer behaviour may have facilitated some exclusionary practices by bus operators and as such is a feature of local bus markets that prevents, restricts or distorts competition.

Combination of features which the OFT reasonably suspects adversely affects competition

- 1.19 The manner in which some LTAs manage competition when combined with the concentration in many local markets may combine to prevent, restrict or distort competition.
- 1.20 In particular, we are concerned about areas that receive low numbers of bids for tendered services. We have seen examples in both large (West Yorkshire) and small (some parts of rural Essex) geographic areas. Issues here cover both the way some local authorities design tender exercises and more structural issues such as where route and network design may encourage gaming of the tender system.

Performance information indicating that competition may be adversely affected

- 1.21 We have estimated that in areas where only one of the large national groups offer services, fares for commercial services are nine per cent higher than in areas where two or more of the national groups operate. This is an indication that competition between operators may be a key factor in controlling fares. Roughly one third of LTAs have principally only one large national operator providing services in their area.

Conclusion

- 1.22 The OFT has decided to make a reference to the Competition Commission under section 131 of the Enterprise Act 2002 (the Act) for an investigation into local bus services in the UK, excluding London and Northern Ireland. This confirms the OFT's proposed decision which was published on 20 August 2009, and on which the OFT publicly consulted.
- 1.23 The Terms of Reference are set out at Annexe A.

2 OVERVIEW

- 2.1 On 5 March 2009 we announced a market study into local bus services and on 20 August 2009, we set out our findings from that study and announced the OFT's proposal to refer the market for local bus services in the United Kingdom excluding Northern Ireland and London to the Competition Commission (the 'CC') for a market investigation. Our reasoning was set out in *Local bus services: Report on the market study and proposed decision to make a market investigation reference (OFT1112)* ('The Proposed Decision').
- 2.2 The OFT invited comments on its Proposed Decision over an eight week period ending on 15 October 2009. In total, we received responses from 74 people and organisations, consisting of:
- one trade association
 - nine bus operators
 - 13 town, city and county councils
 - five Integrated Transport Authorities (ITAs) and Passenger Transport Executives (PTEs)
 - four other public bodies
 - six passenger and worker representative groups,
 - three Members of Parliament, and
 - 33 members of the public.
- 2.3 We also had informal conversations with two investment banks, one credit rating agency, one investment fund and the Confederation for British Industry. We also consulted with the Department for Transport (DfT) who provided a written submission and met with us to discuss our findings and proposed decision. In addition to this we met with the four bus operators that requested a meeting with us.

- 2.4 This document ('the Decision') sets out the OFT's reasons for deciding to confirm its Proposed Decision to make a reference to the CC.

Focus of study

- 2.5 This market study was motivated by a variety of information received from various sources. This included information from complaints coming into the OFT about alleged predatory and other exclusionary behaviour, data about market performance obtained during our mergers work and data about the costs of procuring supported services. This information prompted us to ask questions about whether local bus services work well for customers.
- 2.6 This information, and hence our concerns, related to the local markets outside London and Northern Ireland. During this study we have examined the situation in Northern Ireland and London, and spoken with stakeholders in those two areas but no issues of concern were identified. Consequently the focus of the study has been local bus services markets in the UK excluding NI and London.

History

- 2.7 Since deregulation of the bus industry – outside London and Northern Ireland – in 1986 local bus services have increasingly been, and are now largely, provided by private bus operators² as either commercial services or supported services subsidised by the LTA.³
- 2.8 At the time of deregulation it was thought that each market would be relatively easy to enter and that competition, or the threat of it, would consequently improve services and reduce costs.

² Some services are provided by municipal state-owned bus operators and a small number are provided by not for profit organisations.

³ We use LTA to denote all types of LTAs: Passenger Transport Executives (PTEs), English counties, English unitary authorities, Scottish councils and Welsh councils.

- 2.9 After deregulation there were a large number of small bus operators who often competed extremely fiercely with each other. This period of fierce competition is sometimes known as the 'bus wars', the name reflects the aggressive tactics employed by some operators.
- 2.10 Since deregulation there has been considerable consolidation in the bus industry, leading to the creation of several large operating groups. Since 2004 the OFT has considered 15 mergers between bus operators. In 13 of these cases an independent operator was purchased by one of the four national bus operating groups. There may have been other mergers between bus operators which were not considered by the OFT.⁴
- 2.11 London bus services were not deregulated, they operate on a tender⁵ system where private bus operators⁶ bid for the contract to run a specific route for a specified period of time, usually five years. The letting process is managed by Transport for London (TfL). For the reasons outlined above this study focused on local bus services outside London. We use London only as a comparator principally for tendered services. Similarly services in Northern Ireland have been considered during the course of the study but only as a comparator with deregulated services.

⁴ Notification to the OFT of mergers is voluntary in the UK, although the OFT may investigate mergers on its own initiative. The OFT has a duty to refer a merger to the CC if it believes that it is or may be the case that a relevant merger situation has been created and that it has resulted or may be expected to result in a substantial lessening of competition within any market in the UK.

⁵ In the Proposed Decision we described London bus services as franchised. A number of respondents pointed out that describing it as a tender system is more accurate because, unlike a true franchised system, the revenue risk (and thereby incentive) does not rest with the operator.

⁶ Although they are presently all operated by private operators this need not be the case: until recently East Thames Buses which operated certain TfL contracts was also owned by TfL.

Structure of the industry

- 2.12 There are approximately 500 operators of local bus services, both supported and commercial, in Great Britain, including London. Of these registered operators 45 per cent operate fewer than five vehicles.⁷ In addition to running commercial or tendered services most small operators also run private-hire and excursion services.
- 2.13 For the purposes of this study we have found it helpful to classify bus operators by whether they are part of a bus operating group or whether they are an independent operator: bus operating groups have subsidiaries in different areas, independent operators do not.
- 2.14 There are twelve major bus operating groups in Great Britain. In our view, there are four large national bus operating groups: First Group plc, Stagecoach Group plc, Arriva plc and The Go-Ahead Group plc. We categorise the remaining eight groups as smaller groups, as they operate predominantly in only one or two core geographic areas. These are: National Express Group plc, TransDev plc, Wellglade Ltd, Rotala plc, Veolia Transport, Centrebus Limited, Comfort Delgro Limited, and East Yorkshire Motor Services Ltd.
- 2.15 Some respondents suggested that our description of the industry significantly underplayed the role of the businesses that we classify as smaller groups pointing out that National Express Group's national coach network made it a national player and that TransDev plc, Veolia Transport and also the operator Comfort Delgro were all also national operators.

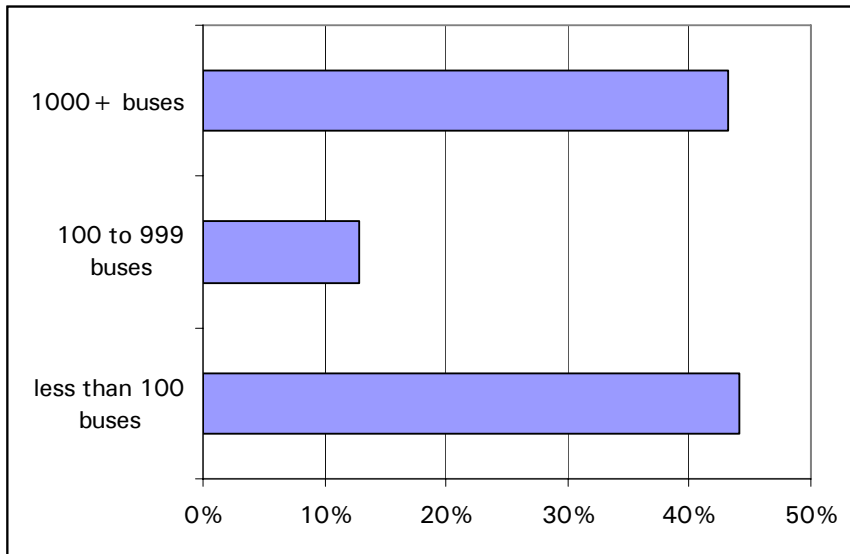
⁷ Vehicles & Operator Service Agency (VOSA). One respondent said that they thought this significantly underestimated the total citing that there are 83 operators in Gloucestershire alone. This figure includes coach operators who operate neither commercial nor tendered services. The published bus timetables for commercial and tendered services in Gloucestershire show 33 different operators providing those services. In the absence of an alternative database we consider that the VOSA data is the most reliable data available.

- 2.16 We note that Comfort Delgro principally have operations in London, whereas the focus of the study has been on services outside of London. Veolia Transport's operations are concentrated in South Wales with relatively minor operations elsewhere. We did not include within the scope the express coach operations of National Express save to the extent that in certain places such coach services perform some inter-urban local bus services. With respect to local bus services National Express principally offer a local network of services in the West Midlands. Based on this we do not consider these operators to be national groups but instead think of them as smaller groups.
- 2.17 Some independent bus operators,⁸ such as Lothian Buses and Nottingham City Transport, have significant regional operations but, generally speaking, there are very few operators of significant scale (more than 100 buses) outside of the twelve major operating groups and the largest municipal operators. As such the industry in Great Britain displays a somewhat truncated structure with a large number of small operators, five very large operators⁹ (1,000 buses or more) and not much in between (see figure 2.1).

⁸ We use the term 'independent' to signify independence from a major group rather than independence from a Local Authority.

⁹ These are the four national groups and one operator based in London.

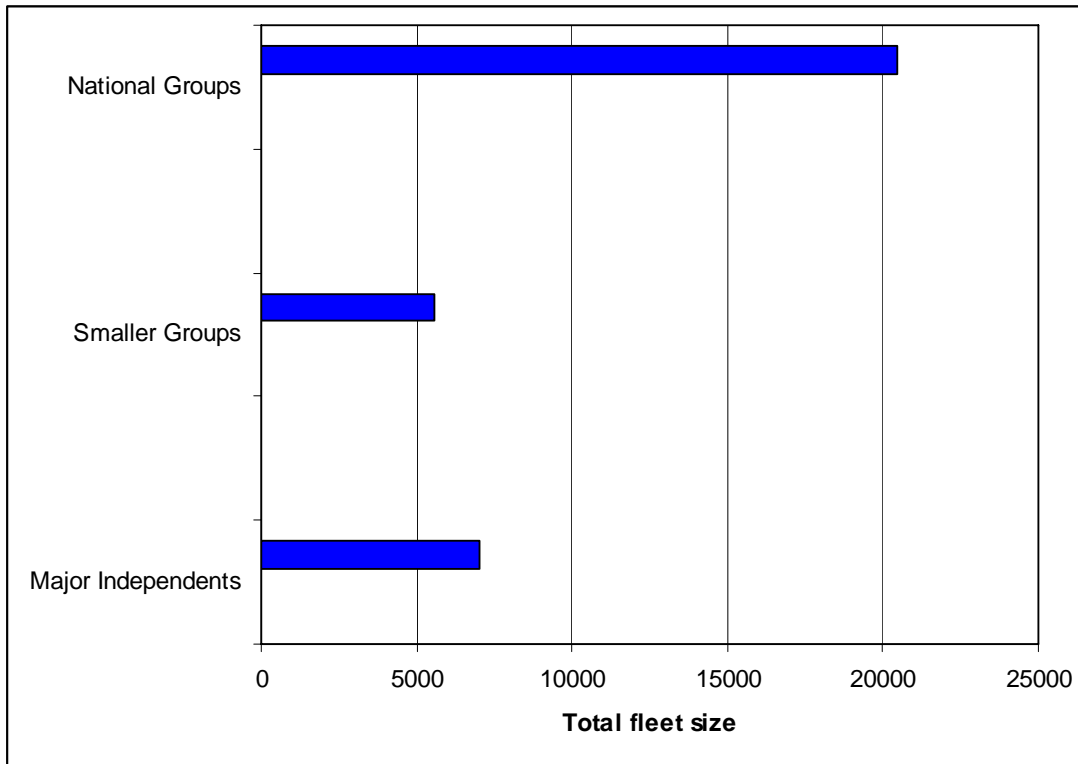
Figure 2.1 Proportion of total bus fleet according to size of own fleet, Great Britain, including London



Source: Vehicles & Operator Service Agency (VOSA)

- 2.18 One respondent suggested that this chart underplayed the role of medium sized players in the industry. They pointed out that the ranges chosen for the graph were 'arbitrary' and that a different classification would give a very different picture.
- 2.19 The classifications were designed to reflect that the national groups have 1000+ buses. A range of 100 to 999 was chosen to capture all the large regional players, in particular the major municipal operators and smaller groups. We have recalculated the graph to compare the national groups, the smaller groups and the major independents, presented as Figure 2.2 below. In doing so we have used an independent source as a basis for the classification: British Bus Publishing produces volumes listing 'Smaller Groups' and 'Notable Independents' and we use this as to categorise our smaller groups and major independents respectively. For clarity we include a list of our categorisation of the major groups and the major independents at Annexe B.

Figure 2.2: Comparative fleet size of national groups, smaller groups and major independents excluding London operations¹⁰



2.20 We estimate the four national bus operating groups operate about 67 per cent of the bus fleet in deregulated markets (that is, UK excluding NI and London).¹¹

2.21 One observation that was raised by several respondents was that many small operators had been driven from the industry by the weight of

¹⁰ OFT calculations based on TAS data and data published by British Bus Publishing in 'English Bus Handbook, Smaller Groups', British Bus Publishing (2008) and 'English Bus Handbook, Notable Independents', British Bus Publishing (2009).

¹¹ OFT calculations based on DfT data.

regulation and not exclusionary behaviour. To the extent that regulation may reduce the numbers of small operators and therefore inhibit competition such regulation could potentially be a feature that prevents restricts or distorts competition and we draw this to the attention of the Competition Commission. The OFT did not identify this feature in the Proposed Decision and has not considered whether it constitutes such a feature in this Decision.

Provision of services

2.22 Outside London the bus network in Great Britain comprises a mix of both commercial and supported services.

Commercial services

2.23 Commercial services are run by the bus operators without requirement for any specific public subsidy.¹² The only restrictions on the running of commercial services are those attached to the granting of a Public Service Vehicle (PSV) licence. Generally, with 56 days notice, the period of notice for route registration, a bus operator is free to start, alter or cancel any service it wishes.¹³

Supported services

2.24 Some bus routes which are not commercially viable may be considered socially necessary. Typically these services are supported by the LTA

¹² There are some subsidies which are provided to all local bus operators, commercial and tendered, for example the bus services operators' grant (BSOG). In addition to BSOG all local bus operators are entitled to reimbursement under the concessionary fare scheme. Concessionary bus passes are valid for travel on both commercial and supported services and the bus operator will receive reimbursement for such passengers.

¹³ For more details about what is required to run a local bus services see: VOSA, 2008, *Local Bus Service Registration, Guide for Operators*. Available at: [www.vosa.gov.uk/vosacorp/repository/Local%20PSV%20Service%20Registrations%20Nov%2008%20\(PSV%20353A\).pdf](http://www.vosa.gov.uk/vosacorp/repository/Local%20PSV%20Service%20Registrations%20Nov%2008%20(PSV%20353A).pdf)

and are known as supported, or tendered, services. Supported services are usually operated by private bus operators and subsidised by LTAs although there are some municipally owned operators and not-for-profit operators.

- 2.25 The contract to run a route is put out to tender by the LTA and bus operators submit bids for the contract. These bids will set out the amount of subsidy that the operator requires to run the service. Once a contract has been awarded that operator is required to run the service to the conditions specified in the contract.
- 2.26 In the majority of cases supported services are secured through a competitive tender. Where a competitive tender is in place tender bids may be accepted from any licensed operators. However, LTAs are able to let any individual bus subsidy contract up to a certain maximum value (the de minimis limit¹⁴) without the need to tender.
- 2.27 Contracts can be let on a minimum cost or a minimum subsidy basis. Under a 'minimum cost contract' the fares are collected by the operator and passed on to the LTA. The revenue risk lies with the authority and not the operator. With 'minimum subsidy' the operator retains all the fares and the LTA pays a set subsidy, so the revenue risk lies with the operator.
- 2.28 The decisions about which services receive subsidy support are based on a number of factors including accessibility criteria and cost. Accessibility criteria are often set limits on the distance bus users need to walk from their home to reach a bus stop, for example 400 metres. In some LTAs the 'tender criteria' are published, these might include details such as:

¹⁴ The current value under these regulations is £29,999 expenditure in any one year for an individual contract. More information about de minimis rules for bus subsidy contracts is available at: www.dft.gov.uk/pgr/regional/buses/gen/guidanceonnewdeminimisrulesf3568

the accessibility criteria, the maximum cost per passenger the LTA is prepared to spend and any other conditions the LTA has imposed.¹⁵

Trends

2.29 Almost 3.1 billion local bus journeys were made in United Kingdom excluding NI and London in 2007/08. With the exception of 2006/07 the number of bus journeys made has fallen by about one or two per cent each year over the past decade.¹⁶ The provisional figures for 2008/09 indicate that bus patronage has risen by one per cent.

¹⁵ See for example Lancashire County Council's *Invitation to tender and details for tenderers* available at www.lancashire.gov.uk/corporate/web/view.asp?siteid=4404&pageid=20774&e=e

¹⁶ In April 2006 free concessionary travel for the over 60s was introduced and the number of bus journeys increased by seven per cent.

Figure 2.2 Bus passenger journeys, Great Britain

	All outside London, million	Percentage change
1997/98	3,149	
1998/99	3,084	-2%
1999/00	3,082	0%
2000/01	3,073	0%
2001/02	3,033	-1%
2002/03	3,023	0%
2003/04	2,989	-1%
2004/05	2,935	-2%
2005/06	2,910	-1%
2006/07	3,104	7%
2007/08	3,074	-1%
2008/09	3,084	+ 1%

Source: Table 6.13, Department for Transport (DfT), 2009, *Transport Statistics Great Britain (TSGB)*

Market size

2.30 In 2006/07 the value of the local bus market in the UK excluding NI and London, was £3.6 billion. This figure contains a large amount of public money.

Table 2.3 Size of local bus market in Great Britain, excluding London, by value at current prices, 2000/01 – 2006/07¹⁷

	00/01	01/02	02/03	03/04	04/05	05/06	06/07
Total value of local bus market, £million ¹⁸	2,496	2,567	2,711	2,928	3,029	3,260	3,629
Public transport support for buses, £million	280	310	332	369	381	430	459
Concessionary fare reimbursement, £million	344	354	397	442	446	493	747

Source: Tables 6.11 and 6.14, DfT, 2008 and 2009, *TSGB*

2.31 As table 2.3 shows between 2000/01 and 2006/07 the market size by value rose 45 per cent in nominal terms. During the same period the number of journeys rose one per cent and spending on concessionary and supported services rose 93 per cent in nominal terms. As with all national data there are likely to be substantial variations in the changes in the levels of spending and number of passenger journeys between different areas.

Public money

2.32 Local bus services receive a large amount of funding. In 2006/07 Government support for supported bus services and spending on concessionary fares in the UK excluding NI and London, amounted to

¹⁷ 2006/07 is the last year for which data on all three heads was available at the time of publication.

¹⁸ Includes passenger receipts, concessionary fare reimbursement and supported services.

£1.2 billion, which represents almost a third of the total revenue of bus operators.¹⁹

- 2.33 There are three main forms of Government funding for local bus services: public transport support for certain bus services which are socially necessary but not commercially viable (supported services awarded by competitive tender unless falling under the *de minimis* limit), concessionary fare reimbursement (available to all bus operators) and the bus service operators' grant (BSOG) (available to all bus operators).
- 2.34 Of these, we are most interested in supported services for the purposes of this study because the system requires active competition in order to deliver best value to the public purse and also because of the relationship between supported and commercial services. In particular, most operators said that supported services are an important 'bridgehead' into establishing commercial services in an area. There are two elements to this: first, an operator will often want to acquire contracts to supply supported services on certain routes before starting to operate commercial services on different routes (see paragraph 4.44).
- 2.35 Second, some commercial bus routes start life as supported services and become commercial services only once they have built up sufficient demand. We also consider the concessionary fares regime because of its potential to distort competition under certain circumstances.

Public transport support

- 2.36 Public transport support for buses is used to provide supported bus services. Supported services are discussed in paragraphs 2.24 to 2.28.
- 2.37 Excluding London £459 million was spent on supported services in 2006/07, this represents more than 10 per cent of total revenue of bus operators and has more than doubled in nominal terms since 1997/98.²⁰

¹⁹ OFT calculations using TSGB, Chapter 6.

²⁰ Source: Chapter 6, DfT, 2008, *TSGB*

It should also be noted that for many of the smaller operators the total proportion of their revenue coming from tendered support is considerably greater than 10% as they operate a higher proportion of supported services relative to commercial services.

- 2.38 In UK excluding NI and London approximately 20 per cent of bus services are subsidised,²¹ although the proportion of routes that are subsidised varies quite substantially between areas.²²

Concessionary fare reimbursement

- 2.39 Concessionary tickets are available to groups such as the elderly, the disabled, children and students. From April 2006 free off-peak²³ travel within a local area was made available to the elderly and in April 2008 the scheme was extended to allow free off-peak travel anywhere in England.

- 2.40 Between 2005/06 and 2007/08 concessionary fare reimbursement in Great Britain outside London rose 80 per cent to £853 million.

Bus service operators' grant

- 2.41 The BSOG is a grant to reimburse bus operators for some of the excise duty paid on fuel used to operate local bus services. In 2006/07 £454m was paid out in BSOG in total (including to London operators). BSOG

²¹ Measured as a proportion of vehicle kilometres. Source: Key Note, 2008, *Market report 2008: bus & coach operators*.

²² Describing supported services as subsidised prompted the response from some respondents that bus operators are not subsidised by supported services: they are simply the procurement of socially necessary services. Government support nevertheless represents a subsidy to passengers on these services.

²³ 'Off-peak' refers to travel after 9.30am Monday to Friday and at all times during the weekend.

payments have been rising in nominal terms over the past few years but at a slower rate than other Government funding for local bus services.²⁴

Other Government subsidy

2.42 In addition to the funding mentioned above there are a number of other ways that public money is used to support bus services. These include a range of grants such as the rural bus subsidy grant.²⁵ In addition there is Kickstart in England²⁶ and the Bus Route Development Grant in Scotland.²⁷

Legal framework

2.43 The current legal framework within which local bus services are operated in England and Wales (outside London) is set out in the Transport Act 1985 (TA 1985). In brief, the effect of the provisions contained in that Act was to deregulate bus markets in the UK outside Northern Ireland and London.²⁸ More details on the legal framework are set out in Annexe B.

2.44 The powers of LTAs were enhanced under the Transport Act 2000 (TA 2000). The TA 2000 introduced Quality Partnership Schemes (QPSs)

²⁴ For more information about BSOG see the DfT's website www.dft.gov.uk/pgr/regional/buses/busgrants/bsog/

²⁵ See www.dft.gov.uk/pgr/regional/buses/busgrants/introductiontobusgrants for more information about bus grants.

²⁶ More information about Kickstart is available at www.dft.gov.uk/pgr/regional/buses/busgrants/kickstart/

²⁷ More information about the Bus Route Development Grant is available at www.scotland.gov.uk/Topics/Transport/BusandTaxi

²⁸ The Scottish Bus Group was restructured by the Transport (Scotland) Act 1989 before being privatised.

and Quality Contract Schemes (QCSs) which are instruments allowing LTAs to require bus operators to meet certain quality standards (see paragraphs 2.46 to 2.49). The TA 2000 also empowers LTAs to set up ticketing schemes, whereby operators of local bus services are required to make and implement arrangements to accept each other's tickets or provide integrated ticketing in ways specified in the scheme. More recently the Local Transport Act 2008 (LTA 2008) has made further amendments in particular in relation to QPSs and QCSs. It has also introduced new provisions about Voluntary Partnership Agreements (VPAs) and other qualifying agreements.²⁹

2.45 In March 2009, DfT and the OFT published joint guidance on the application of competition law to certain aspects of the bus market following the LTA 2008 (the Guidance).³⁰ As explained in its introduction, the Guidance is primarily intended to assist LTAs and bus operators which are entering into, or are participating in, a QPS or other bus partnership agreement, to assess whether the arrangements to which they are a party (or are entering into) comply with competition law. The Guidance also considers how competition law applies to certain aspects of the LTAs' functions in the making and varying of ticketing schemes and the inviting and accepting of tenders.³¹

²⁹ Many voluntary partnership agreements were already in existence prior to LTA2008. Amendments to the 2000 Act made by the 2008 Act introduce a statutory definition of a voluntary partnership agreement.

³⁰ Available at www.ofg.gov.uk/shared_ofg/business_leaflets/general/ofg452.pdf

³¹ There is also a block exemption from the Chapter I prohibition in the CA98 for certain specified types of public transport ticketing arrangements: Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001 SI 2001/319 as amended by the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) (Amendment) Order 2005 SI 2005/3347. The OFT has issued a guideline on the public transport ticketing schemes block exemption (OFT 439). Available at: www.ofg.gov.uk/shared_ofg/business_leaflets/ca98_guidelines/ofg439.pdf

Quality Partnerships Schemes

- 2.46 QPSs are statutory schemes introduced under the TA 2000, under which an LTA - or two or more LTAs jointly – agree to invest in improved facilities at specific locations along bus routes. Such facilities might include bus stops, bus lanes, other bus priority measures or enhanced facilities for passengers at bus stops and bus stations. Operators of local services who wish to use such facilities must undertake to provide services of a particular standard such as running new vehicles or increase the standard of driver training.
- 2.47 Only those operators prepared to provide services to the standards specified in the scheme are permitted to use the facilities. Other operators are not generally prevented from providing local services in the area covered by the scheme, but they cannot use the facilities provided by the LTAs under it. QPSs give enforcement powers to the Traffic Commissioners against an operator that uses the facilities without complying with the requirements of the scheme.
- 2.48 QPS are subject to a competition test,³² the purpose of which is to ensure that any adverse effect on competition is outweighed by the wider benefits to users. The OFT is entitled to investigate whether the making or varying of a scheme complies with the competition test. If it finds that the competition test is not met, the LTA would not be able to proceed with the scheme in its current form and the OFT may require the LTA to vary or revoke it.

Quality Contract Schemes

- 2.49 A QCS is a scheme under which the LTA determines the necessary level and standards of bus provision for the area and grants a particular

³² The Test applicable to QPS is set out in Part 1 of Schedule 10 to the 2000 Act. The OFT and DfT have produced new joint guidance which covers the application of competition law in more detail. Available at: www.dft.gov.uk/pgr/regional/localtransportbill/vpaguidance.pdf

operator the exclusive right to operate certain services following a competitive tender. They are, in effect, exclusive franchising schemes and no other operators may function in the quality contract area. There are, as yet, no QCSs in place although we understand a number of schemes to be under discussion.³³

Voluntary Partnership Agreements

- 2.50 VPAs are voluntary agreements under which an LTA, or two or more LTAs, undertake to provide particular facilities, or do anything else for the purpose of bringing benefits to persons using local services, and one or more operators of local services undertake to provide services of a particular standard.³⁴
- 2.51 VPAs are used as a means of improving the quality of bus services in a particular area. Unlike a QPS, which is a scheme made by an LTA, a VPA is entered jointly by LTAs and bus operators.³⁵ VPAs are subject to a competition test³⁶ which weighs any restriction on competition against the overall benefits to passengers.

Supported services

- 2.52 Commercial bus operators may conclude that some existing or potential routes, in whole or in part, are not commercially viable, resulting in their

³³ The secondary legislation and guidance underlying the 2008 revisions to QCSs have not yet been made and issued by the DfT.

³⁴ A VPA agreement must involve at least one LTA in order to satisfy the definition of a VPA. For example an agreement involving two or more bus operators but no LTA, cannot be a VPA.

³⁵ Unlike a QPS, a VPA does not give any enforcement power to the Traffic Commissioner against an operator who uses the facility without providing the service to the required standard.

³⁶ The test applicable to VPAs is set out in Part 2 of Schedule 10 to the 2000 Act. The OFT and DfT have produced new joint guidance which covers the application of competition law in more detail. Available at: www.dft.gov.uk/pgr/regional/localtransportbill/vpaguidance.pdf

withdrawing from or failing to offer services on them. When this happens, statutory obligations on LTAs (or any other body with similar responsibility) may be triggered.

2.53 Broadly speaking, those obligations impose a duty on the relevant authorities (Passenger Transport Authorities and their Executives in metropolitan areas,³⁷ county councils and unitary authorities in non-metropolitan areas³⁸) to secure the provision of such public passenger transport services as they consider necessary to meet the public transport requirements in their areas, where those requirements would not be met in the absence of such action. The Welsh Assembly has a similar power, though it is under no duty.³⁹

³⁷ Section 9A Transport Act 1968 (as amended).

³⁸ Section 63 Transport Act 1985 (as amended).

³⁹ Section 7 Transport (Wales) Act 2006 (as amended).

3 MARKET DEFINITION

- 3.1 In making a reference to the CC, the OFT's guidance states that the OFT must give 'some consideration to the definition of the relevant market', but 'the effects on competition of some features may be clear enough that firm conclusions on the definition of the relevant market by the OFT are unnecessary.'⁴⁰
- 3.2 Defining a relevant market is not an end in itself but a key step in identifying the competitive constraints acting on a supplier of a given product or service. As such market definition provides a framework for competition analysis.

Geographic market definition - summary

- 3.3 Geographic market definition identifies the appropriate spatial dimension for assessing competitive constraints. In previous merger cases and CA98 cases the area of interest has frequently been the individual routes or point to point flows. This focus has led to individual flows or routes sometimes being regarded as relevant geographic markets. For this market study the area of interest has been with the structure of local bus markets as a whole and not with specific routes or flows.
- 3.4 As has been recognised in previous considerations of bus markets, from the passenger perspective the geographic market is restricted to the particular journey to be made. A passenger wishing to make a bus journey in location A will not typically switch to an alternative bus journey in location B in response to a price increase in location A. So to define the geographic scope of local bus operations we need to look at supplier behaviour.
- 3.5 One aspect of supplier behaviour that we have looked at is the distance that can be served from a depot. Bus operators have told us that they

⁴⁰ OFT 511, 'Market Investigation References: Guidance about the making of references under Part 4 of the Enterprise Act', paragraph 4.8.

will not run a bus service that involves more than 20 minutes of dead running time. This means they will not run a service where the start point of the service is more than 20 minutes from the depot. Clearly in such a circumstance the scope for bus operators to switch their operations to serve a particular location will be affected by the presence of a depot in reasonable proximity to the locality. Some respondents questioned our use of a 20 minute dead-running rule of thumb, this point is addressed at paragraphs 4.8 to 4.14.

- 3.6 Another aspect of supplier behaviour is the extent to which competitive conditions are similar. Many of the larger bus operators with networks of routes offer a zonal pricing system, that is, a common fare structure within a particular geographic zone. Some of these zones cover very large geographic areas (for example, West Yorkshire) and may not reflect a common set of competitive conditions since there may be many route or flow specific fares in addition to the zonal fares. However for some areas where the majority of tickets sold are zonal, it may be relevant to consider the scope of fare zones in considering the geographic scope of local bus markets.
- 3.7 The bus operators we spoke to all agreed that local markets differ. The responses to our survey identified that certain types of competitive constraint – such as cars or trains – are more important in some areas than others. Other local factors such as car ownership, unemployment and the proportion of students in the population all work to create operating environments with their own characteristics.
- 3.8 In this market study we are not concerned with the activities of a single operator or a single local market. Rather we are interested in every local market and the similarities and differences between them. So we have not attempted to define in a precise manner the geographic boundaries between local markets. Instead, we simply identify that there are many local markets with differences between them but that they are linked by a number of national themes some of which effect all, others a majority, of local bus markets. We are confident that the features that we have reasonable grounds to suspect prevent, restrict or distort competition in

local bus markets apply to a majority or all of these markets. An explanation of why our methodology allows us to draw conclusions across many markets is set out at Annexe C and in particular paragraphs C.9 - C.12.

Product market definition - summary

- 3.9 As the discussion on geographic markets above indicates the product market definition in this market study relates not to a single market but many. Local markets differ from each other: social demographics and the type and nature of competitive constraints differ so that in practice a full product market definition for each market would be subtly different.
- 3.10 Despite local market differences it also possible to observe that certain trends link markets together. For example, in our survey all operators have identified the same competitive constraints on their business – they just ranked them differently.
- 3.11 For our purposes in this study it is not necessary for us to define a precise product market for each of the local markets in question. Rather, we consider the products and services applying competitive constraint to local markets in general.
- 3.12 The focus of the study is local bus services, that is, bus services that charge separate fares and have stopping places less than 15 miles apart,⁴¹ and does not include long distance coach travel which is primarily between urban areas and has relatively fewer stops.
- 3.13 The key question in product market definition is whether the alternative options open to a bus traveller are sufficiently close substitutes for bus travel that they can be considered a genuine constraint on the behaviour of bus operators. Only alternatives that are sufficiently close substitutes

⁴¹ This definition is used to qualify for the Bus Service Operators Grant (BSOG) and for concessionary fares reimbursement.

that they constrain bus operators' pricing are to be included in the relevant product market.

3.14 Clearly any given bus operator faces a number of potential competitive constraints. In the 36 responses to our survey the three most commonly identified constraints were:

- other bus operators
- cars, and
- interurban rail services.

3.15 In addition to this some bus operators suggested that we also consider (as we did in our *Cardiff Bus*⁴² decision):

- taxis, and
- cycling and walking.

Market definition - analysis

3.16 At any given point in time a bus user demands a bus service from a particular origin to a particular destination or, over longer periods of time, access to bus services in a particular area.

3.17 A particular operator may not be operating services on a particular route, but if the route is sufficiently close to their existing operations they may be able to add rapidly services if a commercial opportunity arose. All the bus operators we spoke to suggested this was true and they supplied some evidence of such entry.

3.18 The other major bus operators we surveyed recognised a closer competitive constraint from rival bus operators. Stagecoach observed

⁴² *Abuse of a dominant position by Cardiff Bus* (CE/5281/04), OFT 18 November 2008.

that while rival bus operators certainly imposed a competitive constraint, it did not look at competition from buses in isolation. Consequently, its approach to service design and delivery was the same whether or not there was competition between operators.

- 3.19 Other operators (including First and Go Ahead) recognised that the presence of rival operators did cause them to change their market offering in some cases. First provided a number of examples of entry by rivals that had provoked rationalisation and service improvements, while one operator explained that it faced very high levels of 'on-the-road' competition because of the specific geography of the market it operated in.
- 3.20 Our view, however, is that the ability of a nearby operator to commence rival services (or to offer the credible threat of doing so) depends on a number of factors including: the rival operator's size, the size and reputation of the incumbent and whether the rival is part of a large operating group. Accordingly, sometimes the local market will extend to include nearby operators' services and sometimes it will not.
- 3.21 Several respondents (and in particular the major operators) stated that this underplayed the constraint imposed by smaller operators. They pointed out that barriers to entry were low, small scale entry was straight-forward and that there were many examples of entry by small bus companies in areas where the major operators ran services. Our view, as expressed at paragraph 3.20 of this market definition section, is based upon the analysis that follows in the next chapter: we deal with it in more detail there.

Constraint from other modes of transport

- 3.22 Bus operators universally identified the car as a key constraint. In particular, they have pointed to the long term trend whereby bus use has fallen as car use has risen. They also point out the effects that measures which increase the cost of car use, such as removing city centre parking and road congestion charging, have on bus usage.

- 3.23 The bus operators were unanimous in their view that cars are a significant commercial constraint on bus operators. Every operator and operating subsidiary we surveyed said that car travel was either the most important or second most important (behind buses) source of competition they faced. Stagecoach explained it by describing car travel as both an opportunity and a threat: the opportunity was the chance to grow the bus travel market by attracting car travellers, the threat was that they would lose custom to the car.
- 3.24 One operator made the point that rival bus operators only operated services on about 50 per cent of its routes and, it was important to recognise, that its customers mostly wanted point to point services: alternative routes were not generally available. It followed that the main competitor was car travel. Forty-six per cent of its bus journeys were made by passengers who could have used a car with some 42 per cent of passengers citing cost reasons as the principal reason for using a bus.
- 3.25 Another operator explained that the relationship between cars and buses could in part be understood by looking at the role played by partnerships with LTAs. In their view much of the ability of bus services to compete effectively with cars depends on the ability of public sector partners to deliver good infrastructure such as bus lanes and other measures
- 3.26 We recognise that for many customers and for many journeys the car will represent an alternative to the bus. Furthermore we accept that when relative costs of car and bus change in a local area this will tend to lead to some switching between alternative modes of transport. However we do not accept that the constraint from the car would in general be such that it could prevent any competitive harm arising from a lack of competition amongst bus operators. In our analysis reported in paragraphs 4.69 to 4.17308 and Annexe E we found that the proportion of households without a car was an important determinant of the fare revenue in a local area. This is not a formal test of the full constraint from the car since this finding may be affected by other factors such as local income in an area rather than car ownership per se, but is consistent with some constraint on bus services from the car.

- 3.27 We also found, however, that after controlling for car ownership there was a significant effect on fares when comparing local areas with one large national bus operator present and other areas with two or more operators. So our analysis points to the fact that the constraint from the car, and indeed from other modes of transport, would be insufficient to prevent a hypothetical monopolist of local bus services from raising fares by a small but significant amount above the competitive level.⁴³
- 3.28 In addition to specific points about the constraint from the car, two main arguments were made by bus operators: first, that the OFT had considered the various constraints on bus operators separately rather than collectively, and, second, that we had put too much weight on short term fare elasticities and overlooked the evidence from long term fare elasticities.
- 3.29 We do not accept that we did not consider the various constraints on bus operators collectively. One important aspect of our approach to market definition is a consideration of the data on fare elasticities. Fare elasticities are estimated in the face of all the relevant constraints. Although the data we presented in the Proposed Decision related principally to short run elasticities, the data on long run elasticities does not change our overall conclusions. Looked at in the face of all the relevant constraints, a hypothetical monopolist bus operators have pricing power to the extent that they can profitably raise prices above the competitive level.
- 3.30 In the Scotrail inquiry, the CC commissioned OXERA to summarise available studies on bus and rail price elasticities (the sensitivity of bus and rail users to changes in price). This study⁴⁴ found that short-term

⁴³ OFT, 2004, *Market definition, OFT403*. Available at: www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/offt403.pdf

⁴⁴ See *FirstGroup plc and the Scottish Passenger Rail franchise: A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited*, Competition Commission, June 2004, Appendix D.

bus usage elasticities are between -0.35 and -0.5 or, in other words, that bus passengers were generally price insensitive. A hypothetical monopolist bus company in such circumstances could, therefore, profitably raise prices because switching to other transport modes, including cars, would not impose a sufficient constraint.

- 3.31 We also looked at longer term elasticities which capture the pricing constraint from all other modes over a longer period of time. One bus operator provided us with their own estimates of price elasticity. These suggested mid to long term elasticities between -0.4 and -0.6 but with a high degree of regional variation. Several operating subsidiaries of Stagecoach also had their own estimates: these ranged from -0.17 to -0.35. A number of other operators provided case study examples of fare increases that had resulted in increases in revenue (albeit less than proportionate increases).
- 3.32 There is further evidence on long term fare elasticities from a variety of academic studies. The highest figure found by these studies,⁴⁵ of which we are aware, finds that a price increase by a hypothetical monopolist would be profitable in the long run (the exact elasticity is -0.9) although this probably masked significant regional variation with elasticities ranging from 0 to -3.0 in the long run. The study draws attention to the fact that fare elasticity is likely to vary by type of trip, time of day and type of patron.
- 3.33 One bus operator stated that the elasticities cited in the Proposed Decision implied that in areas where there is a monopoly operator it could increase prices profitably, hence was not currently profit maximising. However the elasticities cited in the Proposed Decision were not measured at a level where there are local monopolies hence there is no such inconsistency.

⁴⁵ Dargay, J.M. and Hanly, M. (2002) *The demand for local bus services in England*. Journal of Transport Economics and Policy, 36(1), pp.73-91.

Non-price constraints

- 3.34 One operator suggested that we also consider carefully the research conducted by the Transport Research Laboratory.⁴⁶ We do not rely on this evidence for our market definition, we consider that our case for market definition is made adequately by the weight of evidence presented by the fares elasticity data, although we consider that this evidence supports our original findings.
- 3.35 In our view, evidence from the Transport Research Laboratory (TRL) suggests that there is a constraint on various non-price aspects of service from other modes of transport.
- 3.36 The TRL found that timing is a crucial aspect when considering substitutability between bus services and car travel. The walking and waiting time, that is, non-vehicle time, is irrelevant for private transport. Conversely, walk and waiting times can be a considerable issue for bus passengers. The passenger has to spend time getting to the bus stop and waiting there.
- 3.37 One way to analyse if bus transport is constrained by other modes is by evaluating how bus passengers would value changes in: a) access/egress time, b) in-vehicle time (IVT) and c) service interval levels (which affect the time spent waiting for services). The TRL found that:
- bus passengers value the time they spend waiting at a bus stop more highly than the IVT
 - the elasticity of demand for bus transportation with respect to a change in IVT is less than one
 - similarly, the elasticity of demand for bus transportation with respect to a change in service interval levels is also less than one.

⁴⁶ The Demand for public transport: a practical guide. Transport Research Laboratory report 593, (2004). Available at: www.demandforpublictransport.co.uk/593summary.pdf

3.38 The TRL suggests that there are also non-time factors which should be evaluated when assessing substitutability between bus services and car travel. These factors are: a) the waiting environment, b) vehicle characteristics, c) interchange, d) service reliability, and e) information provided. The TRL found that:

- Passengers principally value: a) how information in the routes is provided, and b) reliability.
- Passengers value relatively less changes in vehicle characteristics (for example, low-floor vehicles) and waiting environment (improvement in shelters and facilities).

3.39 Focusing specifically on car travel, the TRL has evaluated the cross price elasticities between bus transport and car transport. It was found that:

- Bus fare changes have narrow effects on car travel. The elasticity of demand for car ownership with respect to an increase on bus fares ranges between 0.02 and 0.04.
- Conversely, the elasticity of the demand for urban bus transport with respect to an increase in fuel prices is quite high (0.72 and 2.10 in the short and long run respectively).

3.40 The TRL research on the effect of income on bus and car ownership found that:

- As income increases, both car ownership and bus travel demand increase as well. However, the income elasticity of demand for car ownership is higher than the income elasticity of demand for bus travel.
- For those individuals who already own a car, the income elasticity of the demand for bus transport demand ranges between -1.04 and -1.43 in the UK. This suggests that those passengers that already own a car use bus transport less as income rises.

- 3.41 Looking at the TRL data in aggregate, we consider that it is supportive of the conclusions we presented in the Proposed Decision and therefore of the conclusions in this document. In particular, we note that other modes of transport may represent a greater constraint on some aspects of bus services such as reliability and information, than other aspects such as fares. Also it supports the view that LTA measures and other changes, such as fuel price increases, that increase the cost of car use tend to have a substantial positive effect on bus patronage.
- 3.42 While not directly relevant to the issue of competition between bus travel and car travel it does suggest that it is harder to increase bus patronage by cutting fares than it is by increasing the costs of car travel. Of course, the latter is not within the power of bus operators. Similarly, the evidence also suggests that for any given increase in income (leading to a reduction in bus patronage) it would require a correspondingly larger decrease in bus fares to retain those passengers. In our view the long term decline in bus patronage is likely to say more about increases in income than it does about bus service standards or network coverage.

Modes other than cars

- 3.43 We considered the effects of inter-urban rail travel and other mass transit options like trams and metro/underground systems on buses. Our view is that, these alternative modes of public transport may provide a constraint on specific journeys that overlap with particular bus routes depending on factors such as the costs, speed and frequency of those modes relative to the bus. However, because of their limited availability in many places, and the inability of these modes to supplant entire bus networks, means the overall constraint on a network of local bus services is more limited.
- 3.44 A similar conclusion applied to the use of taxis. Although in some circumstances taxis may be a substitute for buses, especially where taxis can be shared to reduce per person costs, we did not find that in general taxis impose a close constraint on bus operators and that, overall, taxis should not form part of the reference markets.

- 3.45 We also considered cycling and walking. Again, there may be some routes where bus journeys can be readily substituted by walking or cycling. It may even be the case that some networks lend themselves to competition from walking or cycling particularly, as First suggested, medieval towns with a small geographic footprint. Overall, our view is that walking and cycling are unlikely to be a sufficient constraint on bus operations to warrant their inclusion in the reference markets.
- 3.46 Finally, we considered all of these various potential constraints together and in so doing paid particular attention to the fare elasticity data. Taken in the round, they would normally be expected to apply a greater constraint than each might do individually. The evidence on bus fares presented above indicates that across a wide range of areas bus users are sufficiently insensitive to price increases to allow a small, sustained price increase to be profitable.

Conclusions on competitive constraints

- 3.47 In the light of this evidence we consider that our conclusions on competitive constraints, as set out in the Proposed Decision, still stand:
- the elasticities data demonstrates that the constraint from the car (and other rival modes) is not sufficiently strong to prevent a local monopoly bus operator from raising prices above the competitive level
 - the analysis of price and concentration suggests that rival bus operators in the vicinity (although not necessarily rival bus services) may constrain bus operators' pricing.
- 3.48 Our overall conclusion that the relevant product market definition is one that includes rival bus services but excludes other modes of transport has not changed from that set out in our Proposed Decision.

Commercial and supported services

- 3.49 Local bus markets are comprised of two types of services, commercial services and supported services. We consider that both types of service form part of the relevant product market. From the bus users point of view there are strong similarities between commercial services and supported services: supported services are often the same route as an established commercial service but at a different time of day or day of the week. In many instances they are operated with similar or identical buses.
- 3.50 From the operators' point of view there are also similarities. Operators can use the same depots, drivers, management staff and, in many instances, the same buses for providing supported work as they do for providing commercial services. In some instances supported services form extensions to the route of an existing commercial service.

Conclusion

- 3.51 Following the above we have not attempted to define in a precise manner each local market. We accept that the exact geographic and product markets will differ as the competitive pressures provided by different transport options and rival operators varies, sometimes significantly, from place to place.
- 3.52 Accordingly, we conclude that for the purposes of this study the relevant markets are the markets for local bus services in the UK excluding NI and London and that the markets do not include car travel, inter-urban rail services or other mass passenger transport systems, taxis, cycling or walking. An explanation of which of these markets is included in the geographic scope of the reference is set out at paragraph 2.6.

4 FINDINGS

- 4.1 In this chapter we set out our findings from the research conducted as part of the market study. Where relevant we draw attention to arguments and evidence put to us in the consultation on the Proposed Decision and we explain whether and why we think these change, or reinforce, our initial view. The chapter is divided into findings regarding commercial services and findings for the concessionary fare regime and supported services. In each we identify features of the market that we have reasonable grounds to suspect prevent, restrict or distort competition in the local bus markets in the UK excluding NI and London.
- 4.2 The first section looks at the tendency for commercial bus services in local areas to become dominated by a single large bus company. Then the barriers to entry into local bus markets are considered which may limit the scope for entry and the threat of potential entry. We also consider market entry and contestability. We then consider the competition for supported services and the factors that affect the strength of that competition. Finally we consider the operation of the scheme of regulation and its possible impacts on competition in local bus markets. Note that although there are many local markets we consider that the features that we identify below apply to most, and in some cases all, of the local markets. An explanation of why we think our methodology supports such conclusions is at paragraphs C.9 –C.12.

De-regulated services

Market structure

- 4.3 The local bus services industry displays a high level of concentration at a number of different levels: at the route level, where there is often only one service provider, at the network/town/local level where there is often a single operator, and at the county/regional level where one operator is often significantly larger than any of its rivals.
- 4.4 The large national groups are of particular interest with respect to geographic market concentration for two reasons: first, they represent

approximately two-thirds of local bus service provision and second, their national scope means that they are likely to approach decisions on where to operate at a national or regional level rather than simply a local one. One concern is that where the large national operators are in contact or reasonable proximity across a large number of local markets this will result in a 'live and let live' attitude where the threat of retaliation in other markets means that the operators tend to respect each others territories rather than seek to compete in new areas.⁴⁷

- 4.5 Several respondents suggested that such a concern was unfounded and based on little evidence. As set out in the Proposed Decision and below, we consider that the regional concentration and market entry behaviour of those operators with multiple market contacts provide the basis for this concern.

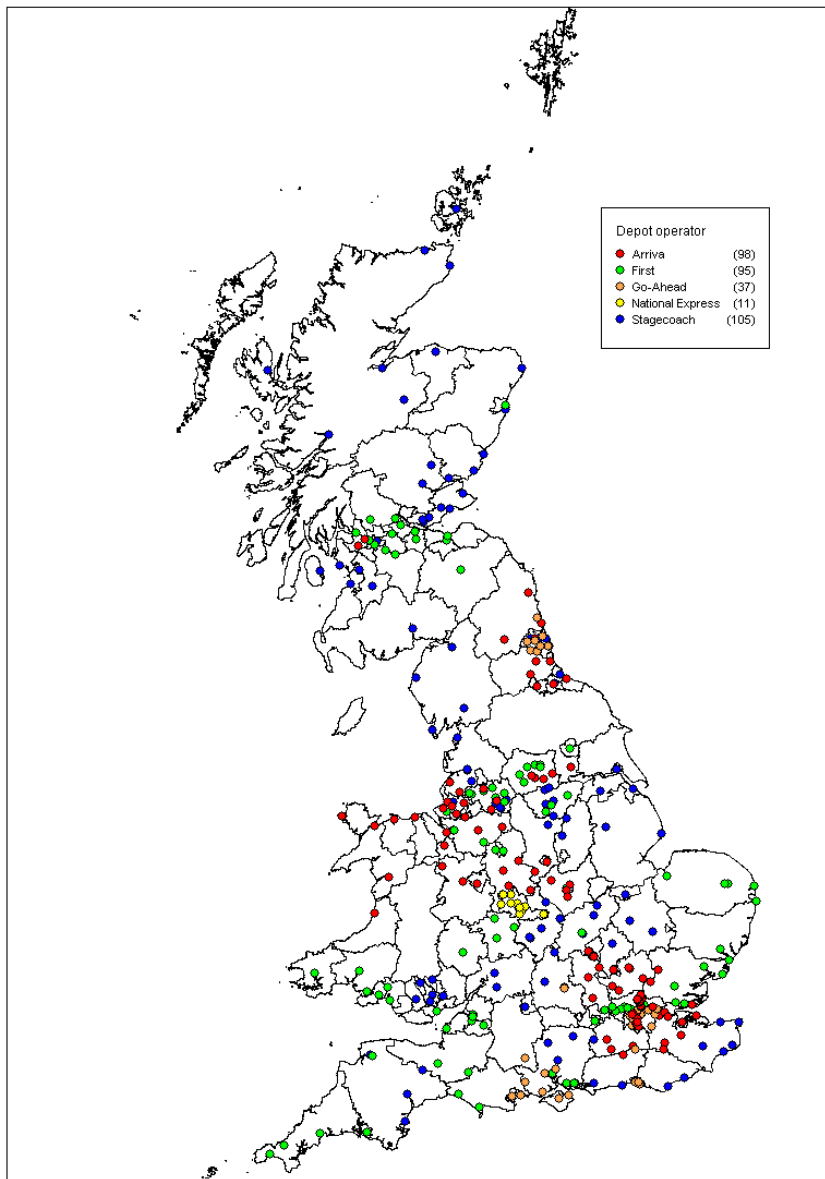
Regional concentration amongst the multiple market operators

- 4.6 In order to assess regional concentration we looked at the geographic location of the depots and outstations of the large national groups at three levels of geographic magnification: national, regional and local.
- 4.7 At a national level, it is apparent that not all of the large national groups operate in all areas of the country. For example, only two of the four national groups have a significant presence in Scotland or East Anglia. One of the national groups has no presence in Wales and the West Country. Indeed there are no large areas of the country where all four national operating groups are present.
- 4.8 The national map of bus depots for the largest five operators is presented at Figure 4.1. This distribution of depots clearly indicates that some of the national operators have clustered depots together into regional areas. There are very few depots that are geographically

⁴⁷ Note that this concern is not dependent on all operators being in close proximity everywhere but rather that most large operators come into close proximity with most other large operators in several areas.

isolated from other depots owned by the group. One reason for this may be the need for a management team to oversee the depots. One national operator indicated that it had tried to operate services using a management team based approximately 60 miles from a depot but this had not proved feasible and it closed the operations from the remote depot.

Figure 4.1 Map of bus depots



- 4.9 The location of a depot affects the routes that an operator is able to run. Bus operators told us that 20 minutes was the average maximum dead running time (the time spent running before starting a route or returning to a depot after completing a route) from a depot for a service to be viable: any further away than this and the costs of the lost mileage are greater than the revenue generated by running the service. In addition there will be greater costs involved in dealing with any breakdowns.
- 4.10 In many areas there are bus stations which are owned by the LTA. These bus stations provide a central point for passengers and many of the bus routes in the locality converge on the station. These stations can be used by more than one bus operator so provide a point of overlap between more than one operator's services.
- 4.11 The location of a bus depot is a key determinant of the routes a bus operator can run. By looking at depot ownership and distribution over time we can get an idea about how the overlaps between the national bus operators' networks have changed over time.
- 4.12 We found that the current pattern of regional clustering of depot ownership has not been much changed over the last 10 years. We also observed that in the last five years there have been very few new depots opened by one of the large national operators in a new area of operation. We found two examples where this had happened: one principally to serve the supported market, the other to provide both supported and commercial services. There was, however, more entry into local areas through acquisition of existing operators and their depots. Bus operators also reported numerous examples of serving new routes from existing depots.
- 4.13 Figure 4.2 shows the overlaps between the 20-minute running time 'footprints' from each of the depots illustrated in figure 4.1. Red indicates no overlaps between footprints, green where two major

operators overlap⁴⁸ and blue where three major operators' footprints overlap. These overlaps approximate the areas where, in theory, local networks served from the respective depots could overlap. There are several examples of places where the 20-minute running time footprints of two or more of the large national operators overlap⁴⁹ extensively.

- 4.14 This analysis was designed to look at areas where, on a hypothetical basis, it would be possible for bus operators to run competing **networks** (which we define as a series of interconnected intra-urban routes, servicing a particular town or urban area). In response to this analysis it was suggested that it was possible to run bus routes for up to two hours in any direction before turning the bus round for the return trip and that many inter-urban services often run for up to an hour away from the depot. Our analysis, however, was focused on the ability of rival operators to replicate a network of services in a town or city.
- 4.15 Even where there is overlap of depot footprints this does not often translate into extensive overlap in terms of the services supplied by the respective depots. On the road competition between operators is more often than not restricted to local network services overlapping with inter-urban services particularly along corridor routes as inter-urban services enter a town. The best example of overlapping local network services between the large national operators appears to be the city of Oxford. In their responses to our surveys the national operators indicated the proportion of their route kilometres⁵⁰ that were subject to direct competition. This varied enormously from area to area, the range being zero to 80 per cent, the average being in the range from 20 to 25 per

⁴⁸ In the white areas services provided by the large national operators will typically originate either in one of the coloured areas, or from outstations.

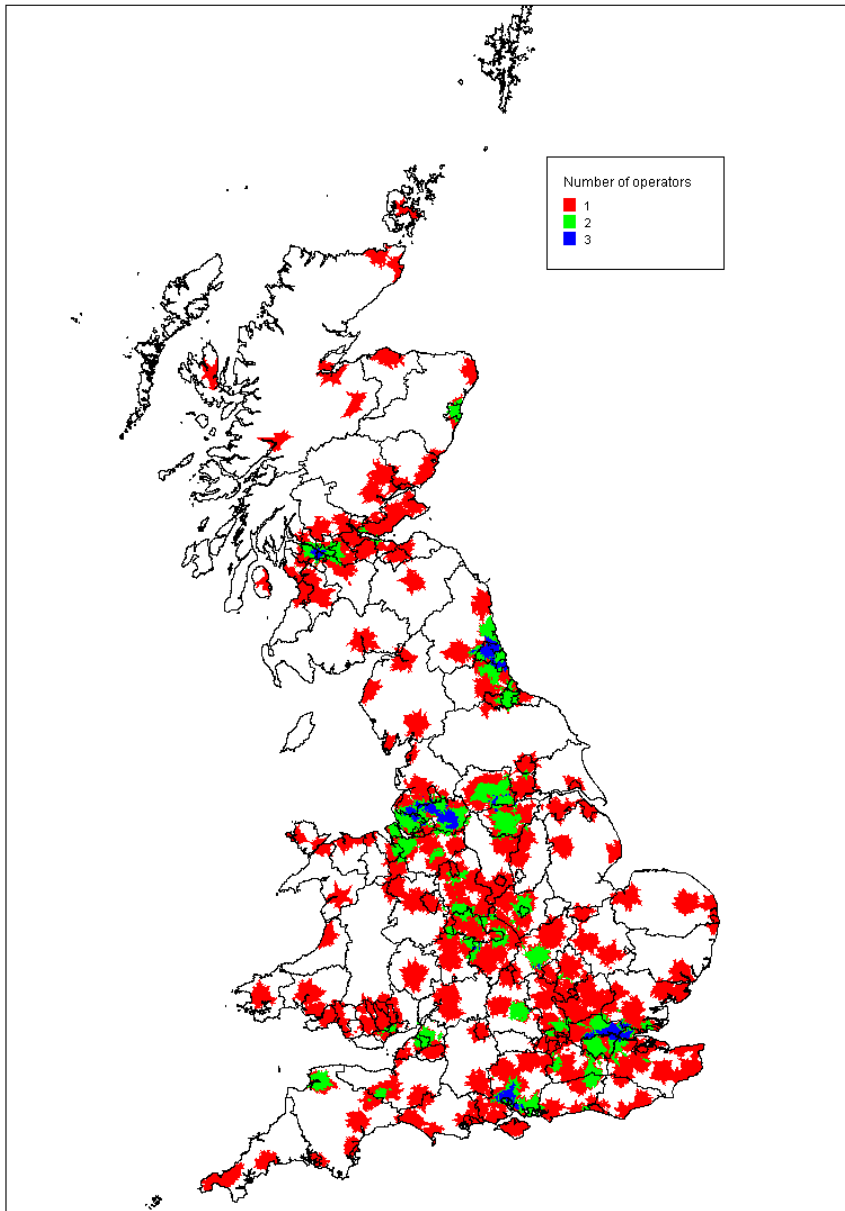
⁴⁹ Specifically we looked at how much territory can be served by more than one operator without more than 20 minutes of dead running time from a depot.

⁵⁰ Route kilometres: the total number of kilometres operated over a route or a network of routes.

cent. These figures include inter-urban as well as intra-urban routes and so reflect all bus services not just local network services.

- 4.16 We also looked at the degree to which services within a given area were provided by more than one of the four national groups. This gives a measure of the number of areas where, at least in theory, the activities of two large national operators may potentially constrain each other. A more detailed discussion of the effect competition between large operators has on prices and quality is contained in the price-concentration analysis at paragraphs 4.69 to 4.108. We calculate that, with respect to commercial services, 35 per cent of LTAs outside London are principally served by only one of the four national groups.

Figure 4.2 Map showing overlap of 20-minute driving time from bus depots



4.17 Several respondents observed that the pattern of services and depots that is currently observed was not the product of an industry agreement or anti-competitive practice but simply the natural result of the way the industry was privatised and the operating economics of the industry.

Moreover, some respondents observed that mature industries tend to be more concentrated than immature ones.

- 4.18 We think that the observation that the current industry structure reflects to a large extent the structure of privatisation, which in turn largely reflected the structure of the nationalised bus industry, is itself instructive of the lack of fluidity in market structure in local areas. The finding of regional concentration is relevant to our discussion of whether the larger operators are likely to enter into one another's operating territories. Given the role of the larger players in the overall provision of local bus services we think it sensible that any competition assessment should include an analysis of this question.
- 4.19 In our consultation with the industry⁵¹ the bus operators made some observations which are of relevance to our finding of regional concentration. Larger operators thought that other bus operators, including smaller operators, were an effective constraint, smaller operators largely disagreed, in the majority of cases they said that they would not challenge a large operator directly even if they thought that operator was underperforming.
- 4.20 The consultation on the Proposed Decision generated a number of responses to this point. A number of respondents said that the evidence clearly showed that smaller operators did act as a significant constraint on bus operators. It was argued that these businesses and in particular the larger independents had won a lot of business from larger commercial operators. Our evidence in relation to this point is presented later (paragraphs 4.63 to 4.66) when we discuss the number of times major operators have experienced new competition.

⁵¹ During the course of our study we surveyed the views of the five largest bus operators individually and spoke to the two main trade bodies, Confederation for Passenger Transport (CPT) and the Association of Local Bus Managers (ALBUM), as a proxy for the 500 or so other operators in the local bus industry.

4.21 For both large and small operators head-to-head competition through 'copycat' services was often a less attractive commercial strategy than developing new routes and services – these might often partially overlap with other services, especially on key corridors.

4.22 From these facts we can observe that the local bus services industry shows a tendency to concentration at a variety of geographic levels:

- at a national level none of the major operators serve all parts of the country with many large areas (for example Scotland, the South West, North Wales) served to any significant degree by only two major national operators
- at a regional level, many large areas and many counties have one very large player with high market share (for example, Aberdeenshire, Cornwall, Lincolnshire, Isle of Wight, West Midlands)
- many towns have only a single player of any significance (for example, Aberdeen, Bristol, Brighton, Cardiff, Cambridge, York)
- most routes are only served by a single operator, although there are frequently portions or parts of routes that overlap with the services of a rival operator (especially on corridor routes) the overall proportion of overlap we estimate at about 25 per cent based on route kilometres served.

4.23 It is apparent that the distribution of bus operators has matured into a stable pattern which is only likely to change slowly over the near future, if at all. One respondent said the recent merger activity demonstrates the market has not matured. We note, however, that if further merger activity occurs in future this may be expected to increase concentration rather than reduce it.

4.24 Another respondent argued that a number of factors meant that there could be no confidence in our conclusion about the stability of the market: smaller operators might gain market share, foreign operators might enter or grow existing operations. We discuss both of these points

later in this report but we do not consider that there is much evidence to support either proposition to any extent which undermines our finding that the current pattern of operators is likely to change only slowly.

- 4.25 That pattern means that there are only a very small number of locations where three of the four large national operators are in close proximity to one another and approximately a third of LTAs (containing one-fifth of the population) are principally served by only a single national operator. In conjunction with the limited examples of competition (see paragraph 4.63 to 4.66) and our findings about the relationship between prices and market concentration set out below, we consider that the geographic concentration of depot ownership and operator distribution may be structural features of the local markets which may prevent, restrict or distort competition.
- 4.26 Our view that the geographic concentration of bus operators may prevent, restrict or distort competition is supported by our work assessing the impact of market structure on bus fares. The findings from this work are discussed below.
- 4.27 Several respondents argued that our analysis focused too much on the major national groups to the exclusion of competition provided by independents including the municipal operators. Our view is not that the larger independents and the municipals are irrelevant but rather that one needs to think about the different levels at which competition takes place and assess them accordingly. First we considered the bigger picture of competition from other modes and found that this is unlikely to constrain price. In this section we consider competition between the major groups – a sensible proposition given their large share of supply – and find that for a variety of structural reasons competition between the major groups is likely to be muted. The final strand of the analysis of commercial services, a consideration of the competition from independents and municipals, is presented later in the report as part of our econometric analysis.
- 4.28 With an industry structure of the major players as concentrated as this, we would not expect competition and passenger choice to provide a

significant constraint on the incumbent operators unless entry into and expansion in the industry by new or independent operators were easy. If new entry and expansion is easy we might expect that the threat of entry will encourage operators to keep prices competitive and service standards high. To assess this, we considered barriers to entry in the industry.

Barriers to entry and expansion

- 4.29 Most of the operators we spoke to argued that entry into the industry was straightforward and that there were few barriers. Second hand buses could be acquired cheaply, especially if they were old, or alternatively could be leased. Depot and maintenance facilities could also be found relatively easily, although this had been suggested to us as a particular difficulty by some parties.
- 4.30 To run services on a significant scale in an area bus operators require a depot in the locality. Depots are owned or leased by a bus operator and are used exclusively by that operator. Bus depots vary in size but will include facilities such as bus parking, maintenance and cleaning facilities along with driver facilities. Many of the bus operators impressed on us that an operator can apparently run a small operation (perhaps up to 10 buses) without owning a depot by renting parking spaces, for example at a haulier's yard, and contracting maintenance work out to a local garage. An operator with more substantial operations will require a depot. The bus operators provided recent examples of small scale entry using temporary facilities at haulier's yards and garages.
- 4.31 Against this, we received one detailed submission setting out a number of difficulties in relation to entering a new market. Acquiring contracts to supply supported services at the same time as a depot was identified as essential and there was an element of timing to this: supported services would not be awarded to an operator without a depot and the operator was reluctant to invest in a depot without some supported services to anchor the operation. In addition planning permission for new depots was not necessarily straightforward or quick to obtain. Some respondents argued that as this was but one operators' view, it was not

enough to be of value. We feel that this is an opinion (supported with examples) that must be taken seriously as it comes from a large overseas operator and is also one of the operators that the major incumbents told us to treat as a serious threat and likely scale entrant to the industry.

- 4.32 Taken together this evidence suggests that entry is likely to be small scale rather than large scale, that it tends to require tendered services to anchor the operations⁵² and that initially depot facilities are likely to be temporary arrangements. Smaller scale entry with dedicated depots does occur⁵³ (indeed the major operators have opened five new depots between them in the last five years). Large scale entry with dedicated depot facilities seems far less likely.
- 4.33 From the evidence we have we do not perceive a particular problem with the acquisition of small scale depot facilities but there may be more significant planning issues around large scale entry requiring a large depot. These issues may be more acute in some urban areas, although not necessarily all: we received mixed views on the issue of whether it was more difficult to obtain depot space in urban areas. However, one might not expect smaller operators to make large scale investments in new areas and as we have discussed above there are structural and economic reasons why large scale operators may not do so.
- 4.34 We remain of the view, as set out in the Proposed Decision that changes in market concentration due to new entry are likely to be slow and incremental.

⁵² A single respondent said this was not necessary. This may be true but the body of evidence we have (consisting of opinions and examples) suggests it is the preferred strategy.

⁵³ Respondents brought to our attention seven new depot openings in the last five years. Five of these were anchored with some tendered services.

- 4.35 We have looked at whether exclusionary behaviour can act as a barrier to entry in an industry that would, at least with respect to small scale entry, otherwise have relatively low barriers.

Exclusionary behaviour

- 4.36 The prevalence of exclusionary conduct by bus operators is a factor that is likely to impact on competition in local bus markets. Bus operators can act in a number of ways to reduce the carryings of their rivals. Such behaviour might include: increasing the frequency of buses on a route to levels designed to 'crowd out' rivals, timing buses to run just in front (and sometimes also just behind) a rival's buses, cutting fares significantly or running buses for free, or declining to engage in multi-operator ticketing schemes to limit the scope for entry or expansion by smaller operators.
- 4.37 Clearly behaviour such as running additional buses and cutting fares can be normal competitive conduct. However if firms would not engage in the conduct, or engage in it to the same extent, without the aim of damaging or excluding rivals, then the result can be harmful to competition and consumers in the long run. Indeed even in the short run, where changes to the timing and frequency of buses occur leading to greater unpredictability of service consumers may suffer.
- 4.38 Exclusionary behaviour damages competition in the following ways. First, if successful, it leads to a loss of competition on the bus route in question, reducing the incentive for the incumbent to provide a good value, frequent and reliable service.
- 4.39 Second, by denying a competitor access to one route, it may reduce or remove the competitor's ability or incentive to enter the incumbent's other routes. In this way, some of the incumbent's routes which were disciplined by the threat of potential competition become free from a competitive constraint.
- 4.40 Third, by being seen to act in this way towards possible entrants, the incumbent may develop a reputation for aggressive response to any

entry or competition from other operators. This reputation may deter potential entrants who might otherwise have entered the market. A reputation acquired in one area for an aggressive response to entry may be carried over to other areas where they operate.

Allegations of exclusionary behaviour

- 4.41 The OFT has received many complaints about alleged exclusionary behaviour by bus operators. Since the CA98 came into force in March 2000, the OFT has received around 30 complaints concerning predation or other forms of exclusion in bus markets, approximately one every four months. Out of these, the OFT has made one infringement decision,⁵⁴ one non-infringement decision⁵⁵ and has in addition undertaken four other investigations.⁵⁶ While exclusionary behaviour may take the form of predation, it may also take other forms, such as overbussing. In this context we use overbussing to describe a temporary increase in frequencies that is designed to undermine a rival bus operator. Predation can be an infringement of Chapter II of the Competition Act 1998 and Article 102 of the Treaty on the Functioning of the European Union (TFEU)⁵⁷ but only if the operator holds a dominant position on a relevant market. Where the operator does not hold such a position, predation would not be an infringement but might still have exclusionary effects -

⁵⁴ OFT, 2008, *Abuse of a dominant position by Cardiff Bus* (CE/5281/04). Available at: www.of.gov.uk/advice_and_resources/resource_base/ca98/decisions/cardiffbus

⁵⁵ OFT, 2004, *Decision of the Office of Fair Trading No. CA98/05/2004 First Edinburgh / Lothian*. Available at: www.of.gov.uk/advice_and_resources/resource_base/ca98/decisions/lothian

⁵⁶ These investigations were closed for a number of reasons including a lack of sufficient evidence.

⁵⁷ Following the entry into force on 1 December 2009 of the Lisbon Treaty, Articles 81 and 82 of the former EC Treaty are now Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU).

this may be especially likely when an operator new to an area attempts to exclude an incumbent. We refer to this situation as overbussing.

- 4.42 Several respondents observed that if the OFT had not opened enquiries into these cases that the evidence supporting them could not have given rise to material concerns. This is certainly not the case. The OFT receives far more complaints than it can investigate and so it prioritises its work. While it would not be possible for the OFT to investigate every allegation of predation it receives, and of course we make no assertion that every complaint about predation in the bus industry would have resulted in an infringement decision if investigated, it is quite legitimate to use the number and frequency of complaints about a matter as an indication of potential problems. This is particularly so in the context of whether a CC reference is appropriate to carry out a detailed investigation into concerns raised about a market sector.
- 4.43 During the course of the market study, the OFT received information about two instances of current alleged exclusionary behaviour. During the course of the consultation on the Proposed Decision we received two further allegations about current exclusionary behaviour from bus operators. Each of these allegations came with significant evidential support and they came from significant independent operators who operate on average 35-40 buses each. In addition to specific complaints, when conducting its merger control function the OFT sometimes receives allegations or suggestions of exclusionary behaviour from third parties.
- 4.44 During the market study many of the LTAs and some operators we spoke to said that in their view smaller independent operators tend to concentrate on supported services as they do not wish to take on the major operators on commercial routes: largely because of a fear (justified or otherwise) that they would be subject to an aggressive, exclusionary response. During our study we found very few examples of supported services being used as a platform to launch commercial services in an area although there are a great many providers of supported services. This seems somewhat surprising given the survey responses mentioned

in paragraph 4.113 to the effect the supported services are an effective 'bridgehead' into commercial services. This supports the assertions made by LTAs about the fear of aggressive response to entry.

- 4.45 One respondent suggested that perhaps what we were observing is that it is significantly more difficult to run commercial services than tendered services and that operators of tendered services were staying with market they knew best. It may be the case that the difference between commercial and tendered services is one reason that some operators stay with tendered services. However, this does not explain the predation allegations and the views of some small operators about the threat of predation.

Exclusion and multi-ticketing arrangements

- 4.46 One of the trade bodies also suggested that operators with an established network had little commercial incentive to participate in multi-operator ticketing schemes with local rivals (which must be distinguished from multi-modal ticketing schemes, for example combined train and bus tickets, which we observe from operator's survey responses are more common). Operators with large networks, it was claimed, had more to lose from allowing operators with a smaller route network to 'piggy-back' on their more extensive service offering than they gained from being able to offer their own passengers the advantages of using the smaller rivals' services. If so, this could dampen competition by making it more difficult for new entrants to establish services in direct competition with incumbent operators.
- 4.47 It is difficult, on the available information, to draw a direct conclusion that operators with high market shares are deliberately not engaging in multi-operator ticketing schemes in order to dampen competition. Nevertheless, we can observe that at least one well informed source believes this to be the case. We also observe that multi-modal ticketing, which arguably poses a weaker competitive threat, is more commonly implemented than multi-operator ticketing. In our survey of operators all had entered into multi-modal ticketing arrangements but only 56 per cent

(20 of the 36 respondents) had entered into multi-ticketing arrangements.

- 4.48 Respondents who disagreed with this finding made two observations. First, multi-modal ticketing is more common because it is more popular. Second, the pricing of multi-modal ticketing often leaves little room between an operators' network ticket, and a multi-modal ticket for a further price point for a multi-operator ticket. There are also lots of examples of integrated ticketing of one kind or another.
- 4.49 Set against these arguments other respondents observed that some areas do not have integrated ticketing even though there appears to be customer demand for it. They observed that integrated ticketing was driven more closely by the desires of the operators and the level of engagement of the Local Transport Authority. With respect to operators they pointed out that both smaller operators and larger operators can have valid commercial reasons for not wanting to join a commercial ticketing schemes (with respect to smaller operators revenues from such schemes would not necessarily cover the costs).
- 4.50 With respect to Local Transport Authority engagement, while in England and Wales powers exist under section 135 of the Local Transport Act 2000 to compel operators to set up multi-ticketing schemes their limited use, despite some LTAs expressing concern with a lack of multi-ticketing arrangements (or in some cases that design), suggests that the powers may not be as widely effective as some respondents suggested that they may be.

Conclusion on exclusionary behaviour

- 4.51 Without investigation we do not know whether the complaints about predatory and exclusionary behaviour would, if investigated, lead to an infringement decision under the Competition Act 1998. However, the fact that the OFT has received a high number of complaints, including four since the Cardiff Bus infringement decision was issued, suggests that smaller operators in particular at least perceive a serious threat of such behaviour.

- 4.52 We believe that this perception of a very aggressive exclusionary response to entry to commercial routes is a feature of local bus markets that may inhibit competition, especially entry into commercial services by small bus operators.⁵⁸ The OFT, therefore, has reasonable grounds to suspect that it is a feature of the market for the supply of local bus services in the UK excluding NI and London that may prevent, restrict or distort competition in local bus markets in the UK excluding NI and London.
- 4.53 We also believe that the reluctance of some operators to participate in multi-operator ticketing absent any specific incentives represents a feature of local bus markets which may prevent, distort or restrict competition.

Conduct of consumers

- 4.54 There may be considered two types of consumers of local bus services. Firstly paying passengers and secondly LTAs who procure supported services on behalf of passengers and who also make arrangements for concessionary fare payments. The activities of LTAs in procuring supported services are dealt with in paragraphs 4.144 to 4.152 below.
- 4.55 To the extent that exclusionary behaviour does take place it may be exacerbated by the conduct of paying passengers. We asked the bus operators we spoke to whether brand identities and brand loyalty were strong for their businesses. Most operators observed that brands generally were not strong and that consumers were happy to use rival buses if they arrived at a stop first. The exceptions to this tended to be where the brand had a strong local identity and we spoke to a couple of smaller local operators who considered that their brands were stronger than average for this reason. During the consultation on the Proposed

⁵⁸ Some respondents observed that an aggressive response was to be expected as the incumbent firm would wish to protect its market share. Whatever the motivation for such an aggressive response, it would still be expected to have an effect on potential entrants and therefore on competition.

Decision several respondents expressed the view that this was equally true of the municipal operators who, it was said, often had strong brands and reputations locally.

- 4.56 Overall, however, weak brand loyalty may exacerbate exclusionary activity. If consumers are disposed to using the first bus that arrives at a stop serving the required destination this makes over-bussing a particularly effective exclusionary tactic as the 'victim' of over-bussing cannot fight back with a stronger brand based on better service.
- 4.57 A number of operators questioned this logic. They argued that weak brand loyalty should increase competition not weaken it because it made entry easier and because it deterred predation and because it made recoupment of the costs of predation more difficult (as it allowed for the re-entry).
- 4.58 Low brand values can certainly make entry easier in some markets however brand loyalty is not necessary for the existence of barriers to entry. We have identified barriers to entry in local bus markets at paragraphs 4.36 to 4.53 above. In particular, while consumers may not be particularly brand aware, potential rivals may well be aware of the reputation of a particular operator. The creation of such a reputation can inhibit re-entry following predatory conduct.⁵⁹
- 4.59 It is also worth noting that the behaviour of consumers may have effects on bus services even without exclusion. Operators who invest in higher quality services can have a proportion of their demand abstracted by lower quality services if consumers are inclined to travel on the first bus that serves their required destination. This may lower the overall incentive to invest as high quality operators may be reluctant to invest in higher quality services which expand demand, only to see that demand abstracted by lower quality operators.

⁵⁹ For example, see: *Predatory behaviour in UK competition policy* (November 1994), Economics research paper 5, prepared for the OFT by Geoffrey Myers.

- 4.60 On balance, we believe that consumer behaviour may have facilitated some exclusionary practices by bus operators and as such is a feature of local bus markets that may prevent, restrict or distort competition. To be clear, we are not saying that consumer behaviour is, in some sense, 'wrong' but simply that the way passengers' interact with bus services will, inevitably, have an impact on how bus operators position their services competitively.

Market entry and market contestability

- 4.61 Given our findings above in relation to concentration and barriers to entry it might be expected that local bus markets would be characterised by two problems: low levels of market entry from new operators and higher prices and lower quality as a consequence.
- 4.62 We examined this hypothesis in two stages. First, we looked at the level of industry entry and second, we considered whether local bus services markets are contestable.

Examples of competition between operators

- 4.63 In our operator survey of First, Stagecoach, National Express, Go-Ahead and Arriva (see Annexe C for full details of this survey) we asked them to provide examples of new competition over the last five years in the local bus markets where they are active. This might include examples where they had entered a new market or where another operator, national or otherwise, had entered against them. In the 36 responses we received from the operators and their subsidiaries approximately 250 examples of competition over five years were given.
- 4.64 The examples were not always examples of direct head-to-head competition. In some instances the actual competitive constraint exerted by these occurrences appears limited, several examples related to situations where an operator had won the contract to run a supported service along a route which was run on a commercial basis at different times, for example a route run commercially during the day and supported in the evening. In some instances these services were on

different days. There were also instances where the examples given were of competition for the market, when a contract for a tendered service was competed for with a different operator. The third type of example related to entry on commercial routes, some of which overlapped with the incumbent operator's services. In summary, the almost 250 examples covered the full spectrum of competition: from the most intense to the least intense.

- 4.65 There are about 500 local bus services operators in Great Britain (including London) and thousands of bus routes. Over the last five years there has been an average of fewer than 50 instances of new competition per year involving First, Stagecoach, Go-Ahead, Arriva or National Express. Furthermore, not all of the instances of competition identified refer to the strongest form of competition rather they represent a spectrum from the strongest through to the weakest. Indeed, in some examples we found it difficult to see how any competitive constraint was imposed.
- 4.66 Several operators observed that 250 instances of new competition in five years seemed like a high number. It represents one new case of entry on average every week for a sustained period of five years. However, only a proportion of the figure relates to direct competition, some relates to winning tenders and some relates to marginal changes in competition, particularly entry into an area but not onto a route. However, this raises an important question: if local markets are not the subject of strong direct competition then are they the subject of potential competition? In other words, are they 'contestable'?

Market contestability

- 4.67 Some markets display contestability: even though there is market concentration, the incumbent firms behave as if there is vigorous competition, largely because they fear entry from rivals if they exploit their position. This in turn keeps prices competitive, standards high and reduces the incentive of rivals to enter the market.

4.68 On many occasions during the OFT's merger control function and while we have been dealing with CA98 complaints, bus operators have told us that an operator which is the sole provider of commercial bus services in a local market is prevented from increasing prices above the competitive level by the threat of potential entry from a rival operator. Prior to this market study, the OFT's only detailed study of market contestability was undertaken in the context of the Cardiff Bus case. In the Cardiff Bus decision the OFT concluded that in Cardiff the features of a contestable market were not present.⁶⁰

Methodology

- 4.69 As part of this study, we carried out an empirical test of the contestability hypothesis in the bus industry. In particular, we used an empirical technique called price-concentration analysis which investigates the relationship between price and the level of market concentration using regression analysis. In Annexe E we provide a more detailed explanation of this technique together with the complete results of our analysis.
- 4.70 The basic intuition for using a price-concentration analysis in this context is that if bus markets are contestable fares should be independent of market concentration. A finding that fares depend on concentration shows that markets are not perfectly contestable (it does not however rule out the possibility that potential competition exerts some influence on pricing).
- 4.71 It is important to note that a simple correlation between prices and concentration may be caused by a number of factors unrelated to the degree of competition. For example areas that are sparsely populated may tend to support fewer operators (there are fewer commercially viable routes and fewer passengers) and may be characterised by higher

⁶⁰ OFT, 2008, *Abuse of a dominant position by Cardiff Bus* (CE/5281/04). Available at: www.of.gov.uk/advice_and_resources/resource_base/ca98/decisions/cardiffbus

operating costs. Consequently, higher prices will naturally be observed in areas where there are fewer bus operators, independent of any threat of entry or competition.

- 4.72 In order to be confident that our price concentration analysis is as far as possible picking up a competition effect we have sought to control for the alternative explanations of price concentration correlation. In particular we have controlled for the effects of population density and various other socio-demographic characteristics in each area we examined as well as for variations in operating costs between areas. Full details of these controls are contained in Annexe E. We are, as a result, confident that our findings represent the effect from competition (or the lack of it) and not the effect from population density or other factors.
- 4.73 Our measure of price is the average fare charged by national bus operators in LTA areas across the UK (excluding NI, London and the West Midlands⁶¹). We looked at the relationship between fares and the number of national bus operators providing commercial services in a particular LTA while controlling for a range of factors that may influence pricing of bus services, including competition from the car, quality of service, traffic density, journey distance, local cost conditions and socio-demographics.
- 4.74 We also considered the impact of smaller operators on the price charged by national operators in different LTAs across the country. However, in the time available for this study we were not able to obtain all the relevant information which would enable us to measure accurately the

⁶¹ The West Midlands is excluded from our analysis because we are missing the biggest operator in the area - National Express - which did not consent for DfT to release their data to us. We were concerned that including the West Midlands in our analysis might bias our results and so we excluded it from our sample. National Express has challenged this saying that it does not have any record that it rejected an official request for consent for the DfT data to be released. We needed to obtain National Express' written consent to access the DfT data. We requested that consent on three separate occasions during the study. National Express did not respond to those requests, hence we were unable to obtain consent.

impact of smaller operators and so this aspect of our analysis needs to be treated with caution.

Data

- 4.75 The main data used in our analysis comes from the STATS100 database held by the DfT. This database is compiled from financial year returns to the DfT from bus operators licensed for 20 or more vehicles. It contains information on passenger boardings and receipts, revenue support, concessionary fares, vehicle miles, fleet size, type of vehicles used, operating and administrative expenditure, depreciation and profitability.
- 4.76 We supplemented this data with the data on car ownership and socio-demographic data which is compiled by Office for National Statistics (ONS) in England and Wales and the General Register Office for Scotland in Scotland. We also obtained a list of names, addresses and the number of vehicles of smaller bus operators in the UK from the Vehicles & Operator Service Agency (VOSA).
- 4.77 Operators have criticised certain aspects of our methodology, notably the way in which we estimated concessionary passenger boardings. They have also raised various issues about the quality of some of the underlying data. We have considered their points very carefully but after carrying out additional analysis (see Annex E) we concluded that, on balance, our findings are sufficiently robust for the purpose of making a market investigation reference to the CC.

Findings

- 4.78 We found evidence of a positive relationship between market concentration and bus fares. Specifically, our conservative estimate is that the average fare is nine per cent higher when there is only one national operator providing commercial services than when there are two or more national bus operators providing services. We have been unable to identify any sizeable statistically significant effect on the pricing decisions of national bus operators from the presence of smaller bus operators.

- 4.79 We have also found that the effect of an additional national operator on the average fare is likely to be non-linear. Specifically, we found that a change from one to two national operators reduces fares by more than the reduction in fares when the number of national operators rose from two to three. Adding the fourth national operator does not appear to make any difference to the average fare.
- 4.80 A number of major bus operators commissioned Frontier Economics to undertake a review of our econometric work. That review is detailed and technical and our full response to it is set out at Annexe E. To summarise, however, the review challenged both the accuracy of our data and several aspects of our methodology. In what follows we provide a summary of the main arguments.
- 4.81 Frontier argued that our results are sensitive to a small number of LTAs in our sample: 15 LTAs. Furthermore, according to Frontier, the operators identified errors in the way we measured both price and concentration in our study for these 15 LTAs.
- 4.82 Prior to issuing the Proposed Decision we examined carefully our data set in order to determine the extent to which our results may be sensitive to potential data errors and/or different model specifications. As a result of these checks, which also involved asking operators to validate the data, we had pared down the sample substantially.⁶²
- 4.83 In the reduced data set we are left with 55 'monopoly' observations. The 15 observations identified by Frontier are virtually all in monopoly areas (14 out of 15, or a quarter of all monopoly observations), and the fares estimates for those areas are all at the higher end of the fares range (11 of the highest fares estimates for 'monopoly' areas).

⁶² Taking the dataset at the face value (that is, as reported to the DfT by the operators), and estimating the price concentration regression using all 222 available observations results in a much higher estimate of the impact of market concentration on price than the one we reported.

- 4.84 Given that the purpose of our analysis is to test whether prices are higher in 'monopoly' areas, it is not surprising that removing selectively one quarter of all 'monopoly' observations where the prices are amongst highest in the sample, undermines the result that the fares are higher in monopoly areas.
- 4.85 Frontier has argued that data relating to estimated fares in 14 of the 15 monopoly areas with the highest fares is wrong and has presented alternative estimates using the data provided by the operators.
- 4.86 In our view, the operators have not actually identified that any of our fares estimates from the data that they supplied to the DfT are wrong. They have instead offered alternative estimates using a different method which, for the reasons given at Annexe E, is unlikely to yield an accurate measure of the average fare.
- 4.87 Furthermore, even if there were some merits to the method used by the operators to calculate the average fare, it would be wrong in principle to apply it selectively on part of the dataset in the way Frontier has done it. Using two different methodologies to define the same variable – the average fare - could itself be a source of bias, especially if one methodology is targeted at the specific set of observations, in this case the LTA with high prices which are classified as monopolies in our dataset.
- 4.88 Frontier has also argued that not all of the monopoly areas amongst the 15 observations are accurately defined. We have considered the modifications to the monopoly variable implied if we accept this argument. With verified modifications to the monopoly variable as suggested by Frontier and one of the operators we found that our results remained broadly unchanged with respect to the estimated impact of monopoly on fares.
- 4.89 Frontier argued that we had overlooked the role played by large regional players like the municipal operators. However, as explained at paragraph 4.27 above, our view is not that the municipals are irrelevant but rather that one needs to think about the different levels at which competition

takes place and assess them accordingly. In our original analysis we had included a variable capturing all other operators which included the municipal operators. To investigate the role of municipal operators in a more detail, we have re-estimated our regressions including a variable specifically to take account of municipal operators. The municipal operator variable is not statistically significant, and the inclusion of this variable does not materially affect the estimated impact of the national operators.

- 4.90 According to Frontier, the operators have expressed particular concerns over the accuracy of data for very small LTAs. In order to correct for this effect Frontier used a statistical method which attached more weight in the analysis to larger LTAs. Using this method, Frontier found that the 'monopoly' variable is no longer statistically significant.
- 4.91 We have seen no evidence that data for smaller LTAs is subject to measurement error which would justify the use of a weighted regression in preference to using robust variance estimates which is what we did. Our analysis, which is detailed at Annexe E, shows that there is a much greater variability in price for small LTAs than for large LTAs and that this can be explained by a much greater heterogeneity of smaller LTAs and not by any measurement error.
- 4.92 We have also considered the appropriateness of the weights applied by Frontier in their weighted regression. Our view is that Frontier's choice of the weights is not appropriate. Specifically, we found that that the outcome of Frontier's analysis that the 'monopoly' variable is not significant is driven entirely by just four biggest LTAs in the sample which are given much larger weights than the rest of the sample.
- 4.93 Frontier claimed that we have used an inappropriate cost variable, an operator based average cost per vehicle kilometre and suggested that instead we use average cost per passenger. We disagree that our cost variable is inappropriate. First, we note that our cost variable is statistically significant in our regressions. Second, we have controlled for LTA-specific variation in costs through the use of control variables, including LTA type (for example, rural and urban). We also disagree with

Frontier's suggestion that cost per passenger is a better measure of cost. This is because the two biggest variable cost components – drivers' wages and fuel cost⁶³ – are evidently closer related to the number of kilometres operated than to the number of passengers carried.

- 4.94 Frontier has also questioned the variable we use to control for service quality, the average number of kilometres per passenger, arguing that this reflects not service frequency (as we suggest) but overall stage length, which varies regionally. We think it reflects both. Nevertheless, to test Frontier's hypothesis that the variable is only related to regional variation we examined the data to see if we could find any relationship between the average number of kilometres per passenger and the type of LTA. We could not find any.
- 4.95 Finally, Frontier questioned our approach to control variables claiming that we had excluded a perfectly legitimate control variable (the proportion of people of social class AB in an area which was one of our proxies for income) from our regressions even though this variable was statistically significant. The excluded variable was excluded because it implied a relationship that was economically unintuitive and other evidence told us was unlikely. Specifically, it suggested that income has a negative impact on what people pay for bus services.
- 4.96 Frontier suggested that the control variable should have been left in our regressions because it controlled for the effect of car ownership. This overlooks the fact that our regressions already included a control variable for car ownership, specifically the proportion of households without a car, which is clearly a much more sensible control variable for car ownership than the proportion of ABs in the population. In any case, as we explain at Annexe E, our decision to omit the proportion of people of social class AB from our regression analysis makes no substantive difference to our results.

⁶³ During the consultation process, the operators told us that drivers' wages and fuel cost are two biggest variable cost components.

- 4.97 Having considered Frontier's review carefully we do not consider that it demonstrates our findings are unsafe or inappropriate for the purpose of making an MIR.

Conclusions on market contestability

- 4.98 The data which we have obtained in the course of this study suggests that many bus markets are not contestable. Our analysis indicates that prices are higher where there is only one national bus operator providing services in a local area. This result holds even if a range of factors (see Annexe E) which can be expected to influence pricing of bus services are taken into account. We also found that an increase from one to two national bus operators has a stronger downward effect on bus fares than if any further national operators are present.
- 4.99 Our conclusion on market contestability, however, does not rest solely on the econometric findings. We consider that the evidence put forward in relation to exclusionary behaviour is equally relevant. Exclusionary behaviour (or a reputation for it) as discussed at paragraphs 4.36 to 4.53 above would be likely to reduce contestability to the extent that it would make an incumbent operator feel more secure that rival operators would not challenge it. That operator could then be expected to adjust their pricing and capital expenditure accordingly.
- 4.100 Taken together we think this builds to a story that many local markets (and this may mean anything from a single route to a small network) are unlikely to be contestable. Structural features of low demand, possibly combined with behavioural features like a reputation for predation are likely to make many markets unattractive to new entrants. This finding does not rely on our econometric work.

Fleet quality⁶⁴

- 4.101 Using the same data source, we found evidence that the degree of competitive pressure faced by subsidiaries of the four national operators is one of the factors which have a positive impact on the quality of their bus fleets. In particular, our findings suggest that those operators which are exposed to a stronger competitive pressure tend to have younger fleets. In addition, they have proportionately more buses suitable for access by disabled passengers and more buses fitted with satellite navigation devices and CCTV cameras. In Annexe F, we provide a more detailed explanation of this analysis together with the complete results.
- 4.102 Several operators challenged these findings as inconsistent with their own experience. One pointed out that its fleet was newer in areas where it didn't operate in close proximity to a large rival. Another observed that it put in GPS systems when required to by local authorities and that CCTV was related to crime rates not competition with rivals. Similarly, low floor buses were required by legislation and had little to do with competing with rivals.
- 4.103 Other operators pointed out that they cascaded fleet around their UK operations. The demands of serving TfL contracts meant that new buses started life in London, often moving to the busier and more lucrative non-London areas next and finished their operational life in quieter less lucrative areas. We note that the cascading of fleet is consistent with the finding that newer fleet may tend to occur in areas with more competition as these may be also the areas with the larger markets. We also note that neither Frontier nor the bus operators have made any criticisms of the econometric methodology used in our analysis of the relationship between fleet quality and concentration.

⁶⁴ Several operators pointed out to us that the measures identified here were not good measures of quality: reliability, service frequency and customer service were better measures. We agree these measures would be included in an assessment of overall service quality but data on much of this is unavailable. We have therefore used as an indicator fleet quality of which fleet age is a reasonable approximation.

Conclusions on de-regulated services

- 4.104 The evidence presented earlier indicates that local markets are concentrated at a variety of levels, that new entry is limited and that incumbent operators may exploit these features to charge higher prices and offer poorer service.
- 4.105 Local bus services markets have become concentrated at a number of levels: route, network and region. In many cases, especially in rural and semi-rural areas this may reflect the level of demand available.
- 4.106 In addition, we think that de-regulated markets may be subject to problems with ongoing exclusionary activity by some operators. We consider that this exclusionary conduct, or fear of exclusionary conduct, may act as a barrier to entry, at least for some firms, which may protect monopoly positions on routes that might otherwise sustain stable competition.
- 4.107 We also consider that concentrated markets, where they do occur, may be subject to higher prices especially when there is not another large rival in close proximity.
- 4.108 Taken in the round these conclusions imply that many bus markets may not be subject to particularly strong competition effects with this likely leading to higher fares but perhaps also lower capital expenditure.
- 4.109 An alternative to competition in the market is 'competition for the market': there is only one incumbent supplier at any given point in time but that supplier must first win a competition to become the incumbent supplier. Certain aspects of the local bus services markets in UK excluding NI and London display competition for the market, principally supported services. We examined the operation of supported services to assess whether they raised competition problems and whether any lessons could be learned for the operation of the de-regulated parts of the bus market, we discuss our findings below.

Regulated services (supported services)

- 4.110 In this section we set out our findings concerning regulated bus services. We use the term 'regulated' to mean regulation which affects bus services in some way. In particular we consider: supported services, quality contract schemes and concessionary fares.
- 4.111 This is not intended as a comprehensive summary of regulations that apply to the bus industry (some respondents pointed out that there are large numbers of other regulations which the Proposed Decision did not address) but rather is intended to cover those of immediate relevance to the matters at hand.

Supported services

- 4.112 Supported services are subsidised using public money. These services are deemed socially necessary and may include evening and weekend services on routes which are run commercially during peak times. More information about how supported services are provided is given in the overview in Chapter 2.
- 4.113 Supported and commercial bus services are closely linked. Services can change from being commercially run to being supported and vice versa. It is also possible for a bus operator to use supported services as a platform to launch commercial services in a new locality. In their submissions to the study most operators agreed that supported services can be used as a useful 'bridgehead' for establishing services in a particular locality before branching out into commercial services (although note also our findings at paragraph 4.44 above that this seems to be little used by smaller operators).
- 4.114 In 2006/07 Government support for local bus services outside London was £459 million. The amount spent on supported services has more than doubled over the last decade,⁶⁵ while over the same period the

⁶⁵ Source: Chapter 6, DfT, 2008, *Transport Statistics Great Britain*.

distance run by subsidised services rose about 28 per cent.⁶⁶ The effect of this has been that between 1997/98 and 2006/07 the amount spent per subsidised kilometre rose from 60 pence per kilometre to £1 per kilometre.

4.115 There are a number of reasons why prices could be rising: the services provided might be of higher quality and the introduction of a number of new funding sources such as the rural bus subsidy grant may have meant that LTAs now support more marginal services than previously, underlying costs of provision may have risen, and service providers may have increased their profit margins.

4.116 To attempt to control for these various factors we have looked at the change in subsidy required for like-for-like services, which are reported in Table 4.3 below. The magnitude of price increases has fallen over the past few years but since 2000 costs have risen 109 per cent in real terms.

Table 4.3 Average price increases for contracts renewed on a like-for-like basis

	Nominal average price increase, %	Transport index, %	Real average price increase, %	Compounded real average price increase, % ⁶⁷
1998	11.8			
1999	17.0			

⁶⁶ Annex A, Table 3, DfT, 2008, *Public Transport Statistics Bulletin GB: 2008 Edition*. Available at:

www.dft.gov.uk/adobepdf/162469/221412/221535/224237/408114/publictransportstatistics08.pdf

⁶⁷ The compounded and real average increases differ slightly from those presented in the Proposed Decision due to correction of an arithmetic error.

2000	16.7	3.4	12.9	12.9
2001	20.9	3.9	16.4	31.3
2002	19.6	2.2	17.0	53.7
2003	15.0	3.3	11.3	71.1
2004	12.1	3.2	8.6	85.9
2005	11.2	4.5	6.4	97.8
2006	7.9	3.9	3.8	105.4
2007	4.9	3.0	1.8	109.2

Source: Nominal figures: Association of Transport Coordinating Officers (ATCO), 2007, *Local Authority bus contracts, price, expenditure and competition survey 2007*. Available at: www.atco.org.uk Real figures calculated by OFT using ATCO data.

4.117 A large number of respondents commented on this table. Their views can be grouped into three areas, first, we have not controlled for changes in service quality, second we have used an inappropriate cost index and third, we have misinterpreted the ATCO contract price data.

4.118 We address these points in turn. We did attempt to control for changes in the underlying service quality, as we say clearly at paragraphs 4.115 and 4.116. We used a recognised transport index as our cost index. Those advocating a different index (principally the CPT index) did not explain why the index we had used was incorrect.

4.119 Several respondents brought to our attention that there may be flaws in the ATCO data. In particular, they suggested that some of the data presented in the ATCO contract price index may have been included on an erroneous basis. Specifically, the concern was raised that some of the data has been included on an averaged basis rather than a year-to-year basis - in short that the increases reported for any given year were not annual increases but multi-year increases. They also expressed concern that some of the contracts do not include inflation adjustments so that

the increase at the end of the contract reflected nominal rather than real terms increases.

- 4.120 We had checked this position with ATCO in advance of publication and they had assured us that the data was on a year-to-year basis. Despite this, in light of the concerns raised during the consultation, we have further checked this position. In response to the observations from the consultation ATCO have confirmed to us that the vast majority of contracts (over 98 per cent by value) include annual inflation adjustments so that if tender prices are rising in line with inflation the contract renewal increase would only be expected to be a single year's inflation (that is, the inflationary increase from the last year of the old contract to the first year of the new contract). We observe contract renewal increases significantly above the annual inflation figure which implies that, unless any errors in the dataset are very large, contract prices for like for like contracts are rising above inflation.
- 4.121 The exact extent to which prices are rising above inflation depends on how long the contracts are and whether the figures reported to ATCO reflect either the increase between the last year of the old contract and the first year of the new contract or the average price between the two. ATCO are confident that Local Authorities mostly report a year on year not an averaged figure. Although ATCO do not check every entry they are able to screen out very large figures that are clearly anomalous. Nevertheless, we have further considered whether the figure of 109 per cent cited above would vary if the cost increases for **every** contract were misreported as average increases. If contracts were on average for three years the cumulative real price increase over the period would instead be around 30 per cent, still a considerable real terms price increase over the period.⁶⁸

⁶⁸ We also note the findings of a report prepared for the Department for Transport by the consultants WS Atkins in a report they prepared in 2004. The report notes that although they found it difficult to control for like for like increases that overall they considered that nominal annual increases for the four years to 2004 were in the region of 15 per cent to 20 per cent. The report is available at:

4.122 In the light of this, we do not rely on the ATCO data to provide an exact figure of the increase in real prices but we are confident that the data does indicate a real terms increase in like for like contracts and potentially a significant one.

4.123 We spoke to, and collected data about supported services from, all seven PTEs in Great Britain.⁶⁹ We also contacted four non-PTE LTAs: Kent County Council, Norfolk County Council, the Highland Council and Ceredigion County Council.⁷⁰ Combined, the local bus services in these areas represent more than half of all commercial and supported bus services in the UK excluding NI and London.

4.124 We obtained data from each of these LTAs about their contracts for supported services over the last five years.

Data analysis

4.125 We used the data for a number of purposes:

- to assess the level of competition in each area by looking at the average number of bids and the proportion of contracts receiving one bid
- to assess how often commercial services were withdrawn and then replaced as supported services to examine the possibility of the tendering system being exploited, and

<http://webarchive.nationalarchives.gov.uk/+/http://www.dft.gov.uk/pgr/regional/buses/tendering/enderingfinalreportfulld3579.pdf>

⁶⁹ Centro (West Midlands), Merseytravel (Merseyside), Nexus (Tyne and Wear), South Yorkshire PTE, Strathclyde Partnership for Transport, Greater Manchester PTE and Metro (West Yorkshire).

⁷⁰ These areas were chosen to survey the tendering environment in a range of non-metropolitan areas: from Kent which is the largest non-metropolitan LTA to the less densely populated area of the Scottish Highlands and Islands.

- to assess the level of head-to-head bidding between the five largest bus companies: Arriva, Stagecoach, National Express, First and Go-Ahead.

4.126 The results from the analysis of these data are discussed below.

Results

Level of competition

- 4.127 In local bus markets, competition for the market occurs when operators compete with one another to win a contract to run supported services. The degree of competition to win a contract will typically depend on the number of bidders for that particular contract. In general the price paid to support a bus service will tend to be higher when there are fewer bidders.
- 4.128 The design and execution of a contract can also have a major impact on the level of competition for each contract.⁷¹
- 4.129 Although under some circumstances only two bidders are needed to generate a competitive outcome, generally a more competitive outcome becomes more likely as the number of bidders increases, assuming the bidders each act independently.
- 4.130 Even within the same LTA the number of bids for different contracts varied significantly. This is likely because individual operators may only bid for particular types of contracts, for example, daytime services. Also, routes nearer to a depot may be deemed more attractive, so contracts that are bundled according to the areas served appear to receive more bids.

⁷¹ There is a good practice guide for bus tendering available on the DfT's website www.dft.gov.uk/pgr/regional/buses/tendering/

- 4.131 By examining the average number of bids and the proportion of contracts receiving one bid we could use the data provided by the LTAs to assess the competitiveness of the tender market for supported services in different areas.
- 4.132 Analysis of bidding data supplied by the LTAs shows a mixed picture but overall one where competition is weak. In more than half the areas we studied (six out of 11) the LTA received three bids or fewer on average per tendered contract (see tables 4.4 and 4.5). Similarly, in more than half of the areas (six out of 11) more than 20 per cent of tendered contracts received only a single bid. Looking across all 11 areas the average number of bids per tendered contract is 2.95 and across the UK excluding NI and London a quarter of all tendered contracts receive only one bid.⁷²

Gaming

- 4.133 Some of the LTAs we spoke to expressed concern about the exploitation of the supported services regime through the strategic manipulation of commercial routes or so-called 'salami slicing'. For example if an operator stops running to the final stop on a rural service it is likely no other operator will be able to run only that section of the service as efficiently as the incumbent.
- 4.134 This presents the possibility of 'gaming' the system where a commercial operator can withdraw from part of a service, which is still commercially viable, knowing that the LTA will subsidise this service and the incumbent is the only credible bidder.⁷³ We might expect there to be a

⁷² Source: Local Authority Price, Expenditure and Competition Survey 2007. Available at: <http://atco-uk.com/index.php?PHPSESSID=93408cd71fe7c1e33acd17cdca3a29c3&action=tpmod,dl=item16>

⁷³ The implied benefit to the operator is that it receives revenues from the LTA in addition to the commercial revenues on what is, in effect, a viable commercial service.

higher level of service withdrawal when there are fewer potential bidders for any contract.

- 4.135 Due to incomplete data we were unable to identify how often an operator withdrew a commercial service and then won the subsequently tendered route. However, one way that 'gaming' of the system might be demonstrated in the data is to see a positive correlation between the proportion of bids that receive one bid and the proportion of commercial service withdrawals. We tried to gather data to analyse how frequently commercial services were withdrawn in order to assess how prevalent 'gaming' might be.
- 4.136 The data is not available to allow us to calculate how many tendered contracts that were renewed during the period in question had at some point in the past been a commercial service. Two tentative observations can nonetheless be made: first the data indicates a lower level of commercial service withdrawal in non-PTE areas, second it indicates that in most PTE areas commercial service withdrawal is positively correlated with a lower level of competition for contracts. This correlation does not hold for West Yorkshire where competition is very weak but the level of commercial services withdrawal is also low.
- 4.137 Another possible explanation for a positive correlation between the proportion of bids that receive one bid and the proportion of commercial service withdrawals is that where population density is low fewer routes tend to be commercially viable so more routes need to be supported. A smaller commercial market may encourage fewer operators into the area and so, in turn, there will be fewer bidders for each tendered contract. However, the fact that the correlation is observed across PTE areas each of which is a large metropolitan area and has a high population density capable of supporting many commercial routes and numerous operators suggests that this alternative explanation is unlikely to be correct. Ultimately, however, firm conclusions cannot be drawn without further research especially as the small sample size for non-PTE areas cannot be regarded as representative and much of the data was incomplete.

4.138 Some respondents said that we had reached our conclusions on gaming of commercial services on little or no evidence. We consider that the evidence presented here is sufficient to give us reasonable grounds to suspect for the purpose of section 131 of the Act. In our view, gaming implies that there will be greater service withdrawals in areas where the incumbent is confident of winning the subsequently tendered contract: we have evidence that this is the case, the lower the number of likely rival bids the higher the proportion of commercial services that are withdrawn. One respondent pointed out a number of areas where they had recently deregistered commercial services and lost the subsequent tender. We recognise that this happens but the concerns around gaming relate only to a proportion of deregistered services and certainly not to all of them. While, we cannot identify from this analysis individual incidences of gaming, we consider that it suggests that gaming of the market for tendered services may be a feature that affects many local bus services markets.

4.139 Tables 4.4 and 4.5 show the individual analysis results for the different areas.

Table 4.4 Summary data for last five years, PTEs

	West Midlands (Centro)	Merseyside PTE	Tyne and Wear (Nexus)	South Yorkshire PTE	Strathclyde Partnership for Transport	Greater Manchester PTE	West Yorkshire (Metro)
Total number of contracts	336	862	301	275	508	561	1047
Proportion receiving one bid	3%	4%	20%	32%	33%	7%	95%
Average number of bids	4.6	3.8	3.0	2.9	2.2	4.6	1.1
Commercial services withdrawn ⁷⁴	2	n / a	23	32	47	n / a	1
Percentage service withdrawal	0.6%	n / a	7.6%	11.6%	9.5%	n / a	0.1%

Source: OFT calculations

⁷⁴ This is the number of commercial services which are withdrawn and subsequently tendered.

Table 4.5 Summary data for last five years, non-PTE areas

	Kent	Norfolk	Highland	Ceredigion
Total number of contracts	201	50	94	46
Proportion receiving one bid	5%	6%	53%	24%
Average number of bids	4.2	3.1	1.8	1.9
Commercial services withdrawn ⁷⁵	5	3	0	0
Percentage service withdrawal	2.5%	6.0%	0.0%	0.0%

Source: OFT calculations

4.140 On the face of it table 4.4 shows only one PTE, Centro in the West Midlands, where there is a healthy competitive environment. In Merseyside only a small proportion of contracts received one bid but they did not supply data to allow us to analyse what proportion of contracts arose as a result of the withdrawal of a commercial service. West Yorkshire appears to be somewhat of an outlier in the data in that competition looks to be extremely weak: 95 per cent of contracts only receive one bid. However, in Tyne and Wear, South Yorkshire and Strathclyde roughly 20 to 30 per cent of contracts receive one bid which does not suggest particularly competitive environments in these areas either.

⁷⁵ This is the number of commercial services which are withdrawn and subsequently tendered.

Head-to-head bidding

- 4.141 Anecdotally, the LTAs we spoke to told us that national bus operators have their particular geographic area and tend to stick to that with any competition taking place at the overlap of these areas, although our analysis contradicted this to some extent.
- 4.142 The LTAs were also of the impression that large bus operators only bid for supported services that complemented their existing commercial operations. Evidence from our survey of First, Arriva, Stagecoach, Go-Ahead and National Express supports this view. A large majority of respondents said that how well a supported service complements their existing commercial and supported services was one of the three most important factors when they were deciding whether to bid for a contract.
- 4.143 We analysed the head-to-head bidding data to see whether there was evidence of the large bus operators competing against each other more or less frequently for tenders that may be expected otherwise. No general picture emerged. There were some areas where the operators bid less frequently against each other than might be expected but in other areas there was more head-to-head competition than expected. A fuller explanation of our analysis can be found at Annexe G.

Role of LTAs

- 4.144 It appears that the level of competition is significantly influenced by the behaviour of the LTA when they are designing and tendering the contracts for supported services. Some LTAs we spoke to said that smaller bus operators were sometimes unwilling to bid for contracts they considered to be in a national bus operator's area.
- 4.145 In some cases LTAs had made a particular effort to encourage bids from smaller operators and in the LTA's opinion these actions had helped increase competition and control prices. For example, some LTAs had observed that if they announced that a large operator had not bid for a contract or had bid and been rejected and then retendered the contract

they often got more bids the second time. This may reflect a combination of operators' perception of their own competitiveness, a view that a particular contract is in another operators' area and the often significant upfront costs associated with submitting a bid.

- 4.146 In addition to this, some LTAs used a variety of other measures which appeared to have helped boost competition for tenders. All of the LTAs to whom we spoke let each contract individually but all of them accepted 'bundled' bids where an operator put in a bid for a number of contracts. Some LTAs worked hard to encourage bundling and were prepared to alter contract specifications to accommodate proposed bundles, for example running a service five minutes later in the morning to allow a single operator to run a school contract in the morning before running a local bus service during the day. Contracts were sometimes bundled by locality rather than type, this potentially increases the opportunity for smaller operators to exploit economies of scale as smaller operators with a single depot can only bid for a bundle of contracts if they are all near the operating depot.
- 4.147 Informal contact with operators about their future plans had made it easier for some LTAs to assess which new contracts were likely to require supporting in the future. Similarly, contacting small local operators to ensure that they were aware of tenders that had been advertised was likely to result in a higher number of bids.
- 4.148 Some LTAs invited operators to submit a range of bids that were variations on the original specification: a high cost/high quality bid and a lower cost/lower quality bid. This offered the LTA the opportunity of comparing a larger number of bids and playing to the strengths of local operators to secure the best value for money.
- 4.149 Some LTAs provided a lot of information when the contract was announced, for example, about the expected passenger numbers and revenue. This information helped the smaller operators in particular make a more informed bid. LTAs were of the opinion that this information encouraged operators to submit a bid who might not have done so

otherwise because of uncertainty about what the expected revenue would be.

- 4.150 We noted that LTAs employing such methods were often also the same LTAs that employed former bus industry managers to run their supported services. The combination of the two tended to coincide with an LTA receiving a higher average number of bids for its tenders and a lower proportion receiving only one bid.
- 4.151 All the LTAs we spoke to had a number of small operators who solely ran supported services. As a result the policies outlined above which help support smaller operators in the bidding process create a more vibrant tendered market with a larger number of smaller operators. Without these policies the smaller operators would almost certainly exit the local market because, in many cases, they do not run any commercial services. We note that, when it comes to the tendered market, small operators are especially important as the difference between a high number of bids per contract and a low number of bids is, in most instances, the contribution of small operators.
- 4.152 It seems reasonable to conclude that the behaviour of LTAs will have some effect on the behaviour of bus operators, both in terms of the number of operators who bid for a contract and the potential for 'gaming' of the supported services regime.

Conclusions on supported services

- 4.153 In the analysis of the PTE data there is a positive correlation between the number of commercial services withdrawn and the number of contracts receiving one bid. What we have been unable to determine with the available data is how these two facts are related, if indeed they are: this will require further detailed research with better quality data.
- 4.154 We observe cost increases after controlling for route changes and cost inflation. We have not been able fully to control for the effects of higher quality contract specifications, again due to deficiencies in the available data.

4.155 The results of our analysis show a mixed picture across the different LTAs in terms of the competitive environment for supported services, with a small number displaying competitive markets and the majority uncompetitive markets. In some areas the level of competition looks extremely low, for example West Yorkshire PTE where 95 per cent of all contracts only receive one bid. It appears there are only two PTEs, West Midlands and Merseyside, and one non-PTE area, Kent, where the competitive environment for supported services could be described as healthy based on our analysis. The areas we have analysed represent more than half of all commercial and supported bus services in the UK excluding NI and London, and in a majority of these areas competition is not working well.

4.156 In conclusion we observe that there are a variety of features at work in the market for supported services, each of which affects the other:

- LTAs appear to play a significant role: the manner in which they manage competition for their contracts seems to have a material affect on the number of bids they receive.
- The actions of bus operators are also important, bids from smaller operators typically make the difference between a low number of bids and a higher number of bids. The willingness of small operators to bid may be affected by their own perceptions of their competitiveness (which some LTAs thought understated the reality) and their expectations of whether larger rivals were likely to bid.
- Market structure plays a role as well, markets that have become dominated by a single player or a small number of players will struggle to achieve high numbers of bids as distance from the operating area is a key factor in the competitiveness of a bid.

4.157 In our view, these features combine to prevent, restrict or distort competition in the markets for local bus services in the UK excluding NI and London. The low number of bids for many contracts is indicative of the adverse effect this feature is having on competition in local bus markets.

Quality contract schemes

- 4.158 A QCS is a scheme under which the LTA determines the necessary level and standards of bus provision for the area and grants a particular operator the exclusive right to operate certain services following a competitive tender. They are, in effect, exclusive franchising schemes and no other operators may function in the quality contract area.
- 4.159 Under the TA 2000, the conditions for setting up a QCS were thought restrictive by many parties and no application for a QCS was ever made. To remedy this, the DfT relaxed the QCS regime in the LTA 2008, however, to our knowledge there have still not been any schemes implemented, albeit that the new regime has only been in force for less than a year and the secondary legislation underlying the new QCS regime have not yet been made, nor yet has the new guidance been issued. There are however a number of schemes under discussion. See Annexe D for further details about QCS.

Concessionary fares

- 4.160 Concessionary tickets are available to groups such as the elderly, the disabled, children and students. In England free off-peak concessionary travel is available to those over 60 on local bus routes to anywhere in England. In Scotland travel on any local bus and scheduled long distance coach services is free at all times for anyone aged 60 or over and many disabled people. In Wales women and men aged 60 or over and disabled people of all ages are able to travel free on registered local bus services in Wales at any time of day.
- 4.161 Between 2005/06 and 2007/08 concessionary fare reimbursement outside London rose 80 per cent to £853 million.
- 4.162 Concessionary fare reimbursement is made by LTAs to bus operators on a 'no better, no worse off' basis, so operators should neither gain nor lose money as a result of carrying concessionary passengers.

Views of bus operators about concessionary fares

- 4.163 During the course of the study bus operators expressed their dissatisfaction with the concessionary fare scheme. The main concern expressed was that the concessionary fare scheme is not revenue neutral despite being designed as such. Bus operators said that in their opinion LTAs failed to take account of the level of passenger growth that resulted because of bus operators' service improvements rather than the effect of concessionary travel. Bus operators also complained about scheme variations between areas. In April 2009 the DfT launched a consultation on possible changes to the administration of concessionary travel in England.⁷⁶
- 4.164 The OFT is a competition authority and any policy decisions affecting the concessionary fare scheme will be made by the DfT. However we looked at the effect of the concessionary fare scheme on competition in local bus markets.

Analysis

- 4.165 During the course of the study it was suggested to us that fares may be higher where a higher proportion of the population is eligible for concessionary travel. The intuition behind this hypothesis is that because passengers eligible for concessionary travel are less price sensitive (they do not have to pay) the greater the proportion of passengers entitled to concessionary travel the greater the incentive for an operator to raise single fares. This follows because concessionary fare reimbursement (the amount received by the operator from the appropriate LTA) is, in part, based on the single fares charged by the operator to non-concessionary passengers. An increase in the single fare might discourage some fare paying passengers but will be offset to a degree by the effect the

⁷⁶ More details available at:

www.dft.gov.uk/pgr/regional/buses/concessionary/informationlocalauthorities/concesstravel/consultationdetails

increase has on concessionary revenues. The greater the proportion of concessionary passengers, so goes the hypothesis, the stronger this effect is likely to be.

Findings

- 4.166 We were able to examine whether there was any support for this hypothesis. During our price concentration study we found that the average fare is indeed higher (and markedly so) in those areas where there is a greater proportion of the population eligible for concessionary fares. We think there are two possible explanations for this. First, this may be due to the error in measurement of concessionary passenger boardings along the lines suggested in Annexe E. However, it could also be due to the fact that operators' incentives when setting single fares to paying passengers may be affected by the fact that these single fares are used in part as a basis for setting concessionary fares which operators recover from LTAs.
- 4.167 If this latter hypothesis is true it is likely to distort competition between bus operators. Competition between bus operators would usually be expected to help hold commercial fares down towards competitive levels but gaming of the concessionary fares regime will give operators an incentive to increase fares above the competitive level.
- 4.168 Several respondents challenged these findings on a factual basis. First, it was argued that the concessionary fares reimbursement regime is designed to take into account operators' increases in fares by applying both short and long term fares elasticities to reimbursement calculations. This, they argued, together with the fact that their concessionary revenue accounts for between 20-30 per cent of their total revenue, means that increasing fares to paying passengers may not be a profitable strategy overall. We note in this regard that the figures for concessionary revenue as proportion of total revenue are average figures. However, in some LTAs concessionary revenue accounts for a larger proportion of the total revenue than the average. This means that in these areas the pro rate increase in concessionary revenue following

an increase in commercial fares may exceed any loss in revenue due to a reduction in demand.

- 4.169 Second, industry consultants such as MCL, who calculate reimbursement rates on behalf of Local Authorities include within their formulae adjustment factors to counter the effect we describe but in reality these have never been used in practice. We note, however, that MCL told the CC⁷⁷ that it had some discretion to scale back concessionary reimbursement if it judged that there were extreme fare increases which were out of line with reasonable justifications. However, this does not mean that this scheme would be effective against smaller but significant increase in an operator's fare structure.
- 4.170 Another respondent observed that the position in Scotland, where Transport Scotland sets reimbursement rates for all operators, meant that the hypothesis did not apply to Scotland. We accept this.
- 4.171 Several respondents also criticised the OFT for making a finding based upon data that was subject to considerable underlying uncertainty. Our finding is not a finding of fact. Rather it is a conclusion that the evidence gives rise to reasonable suspicion that the concessionary passenger regime is a feature that may prevent, restrict or distort competition.

Conclusion on concessionary passenger regime

- 4.172 The evidence on gaming of the concessionary fares regime by operators is extremely mixed. On the one hand, there are recognised difficulties with the recovery of revenue for the services provided by operators under the regime and this creates a plausible incentive for gaming. The data would appear to provide some support for fares being higher in areas where the proportion of the population eligible for concessionary

⁷⁷ Stagecoach Group/Eastbourne Buses/Cavendish Motor Services Merger Inquiry. Competition Commission, October 2009.

travel is high but we know of at least one plausible alternative explanation as set out above.

4.173 We consider that, on the basis of this evidence, we still have reasonable grounds to suspect that gaming of the concessionary fares regime is a feature of local bus markets that may prevent, restrict or distort competition, and is worthy of further consideration by the CC, although we accept that it is not certain that further investigation by the CC will identify competition problems.

Conclusion on de-regulated and regulated services

4.174 As we explain at paragraphs 3.49 – 3.50 above we consider that supported and commercial services are in the same product market. We therefore consider that the features we identify in relation to regulated (supported) services and the features we identify in relation to commercial services apply to same single product market.

4.175 We also consider that the features we identify in relation to commercial services ultimately have an effect on supported services and vice versa. The reason for this is the close linkages between the provision of the two types of service discussed at paragraphs 3.49 to 3.50. For example, exclusionary conduct which excludes competitors from the provision of commercial services may also make it more difficult to operate in the supply of supported services by forcing a would-be operator to focus only on supported services and preventing it from spreading its risks and overheads. Similarly, a weak tendering regime which has not fostered competition for tendered services may result in fewer operators supplying tendered services which in turn reduces the number of operators who might be able to make the move into the supply of commercial services.

4.176 It follows that features that prevent restrict or distort competition in the supply of commercial services can also prevent, restrict or distort the supply of supported services and vice versa.

5 DECISION ON A REFERENCE

- 5.1 In order to make a market investigation reference, the OFT must have reasonable grounds for suspecting that any feature or combination of features of a market in the UK for goods or services, prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or part of the UK (the 'reference test'). Where this threshold is met, the OFT has discretion as to whether in fact to make a reference. This section sets out the two stages of our decision making process.

The reference test

- 5.2 The reference test⁷⁸ sets out the three types of market feature that could have an adverse effect on competition: structural features, conduct of firms, and the conduct of consumers. Our guidance says that there will often not be clear separation between structural features and those relating to conduct. The evidence supporting a reference set out in Chapter 4 covers both together but here we summarise the features which in our view form the basis for a reference and meet the reference test under these three types. The evidence set out in Chapter 4 also finds features that affect both commercial and supported services together (see paragraphs 3.49 to 3.50 for a discussion of this point). In addition we set out performance indicators (for example, on pricing) which the guidance says can be a useful supplement in assessing the case for reference.

⁷⁸ Formally the reference test is set out under section 131 of the Enterprise Act 2002.

Structural features which the OFT reasonably suspects adversely affect competition

- 5.3 The industry has tended to a situation in which routes (especially non-corridor routes⁷⁹) are served only by a single operator. Local areas and towns tend to become dominated by a particular operator that provides most of the services. This may be an inevitable feature of the available demand on these routes and, if so, would not necessarily be a feature adversely affecting competition. In this case, however, given the wider context of regional and local area concentration we suspect that it is such a feature.
- 5.4 The way the concessionary fare regime works may distort the market by creating an incentive for bus operators to raise fares. Competition between bus operators would usually be expected to help hold commercial fares down towards competitive levels but the concessionary fares regime may give operators an incentive to increase fares above the competitive level.
- 5.5 Consolidation of depot ownership has meant that large regions tend to become dominated by a particular operator that supplies most of the services. The pattern of depot ownership at a regional level may be a contributing factor to the concentration in service provision at a local level. It may be that regional consolidation in depot ownership makes smaller operators that come up for sale unattractive to any purchaser other than the dominant local operator as they are only a good regional fit for that operator.

Conduct of firms which the OFT reasonably suspects adversely affects competition

⁷⁹ Corridor routes refer to routes along major road corridors carrying high volumes of traffic, often serving gyratory or radial roads for a town or city.

- 5.6 We have frequently received allegations of targeted competition of the kind that is designed to eliminate competitors without providing any long term benefit to consumers. Without investigating the detail of each allegation we cannot say if any of the behaviour has been predatory other than in the two cases we have investigated. Nevertheless, we suspect that this sort of competition, taken in the context that many smaller operators cite it as a key reason for not expanding services into areas where larger operators have services, is conduct that may prevent, restrict or distort competition.
- 5.7 We were also told that incumbent bus operators with a well developed network had little incentive to enter into multi-ticketing arrangements with smaller rivals as the benefits to the rival were greater than the benefits to the incumbent. Consequently, the OFT considers that it has reasonable grounds to suspect that this is conduct which may prevent, restrict or distort competition.

Conduct of consumers which the OFT reasonably suspects adversely affects competition

- 5.8 Bus users are most likely to get on the first bus that appears at the bus stop going to the destination they want. Most (but not all) operators reported limited brand loyalty and although it appears that in some areas certain consumers will apparently wait longer for a cheaper or better service in most places this is not the case.
- 5.9 This may encourage exclusionary behaviour by making 'over-bussing' a particularly effective strategy: good quality services provided by a new entrant can be undermined by temporarily high frequencies from an incumbent. It also means that investment in higher quality services by an incumbent could be undermined by low quality new entry that abstracts some of the available revenue. We note that both scenarios are made substantially worse if consumers are inclined to get on the first bus that arrives.

- 5.10 We consider that consumer behaviour may have facilitated some exclusionary practices by bus operators and as such is a feature of local bus markets that may prevent, restrict or distort competition.

Combination of features which the OFT reasonably suspects adversely affects competition

- 5.11 The manner in which some LTAs manage competition when combined with the concentration in many local markets may combine to prevent, restrict or distort competition.
- 5.12 In particular, we are concerned about areas that receive low numbers of bids for tendered services. We have seen examples in both large (West Yorkshire) and small (some parts of rural Essex) geographic areas. Issues here cover both the way some local authorities design tender exercises and more structural issues such as where route and network design may encourage gaming of the tender system.

Performance information indicating that competition may be adversely affected

- 5.13 We have estimated that fares for commercial services are nine per cent higher in areas where only one of the large national groups operates services. This is a strong indication that competition between operators may be a key factor in controlling fares. Roughly one third of LTAs have only one large national operator providing services in their area.

Geographic scope of the reference

- 5.14 Section 133(1) of the Act requires the OFT to specify the terms of the reference. Section 133(2) and (3) gives the OFT the power (but not a duty) to frame a market investigation reference so as to limit the scope of a CC investigation by reference to the place where goods or services are supplied or acquired.
- 5.15 We find that in this instance it would be appropriate to limit the geographic scope of the reference to the UK excluding NI and London on

the basis that the features we have identified above relate principally to local markets in the UK excluding NI and London.

Appropriateness of a reference

5.16 Given our view that the reference test is met, the decision on whether to make a reference rests on the exercise of the OFT's discretion. The OFT's guidance on market investigation references sets out four criteria that must, in our view, be met before we decide to make a reference:⁸⁰

- proportionality – the scale of the suspected problem, in terms of its adverse affect on competition, is such that a reference would be an appropriate response to it
- availability of remedies – there is a reasonable chance that appropriate remedies will be available
- alternative powers – it would not be more appropriate to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT or the Traffic Commissioners, and
- undertakings in lieu – it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference.

5.17 These four factors are considered below.

⁸⁰ Paragraph 2.1, OFT, 2006, *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act*, OFT 511. Available at: www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft511.pdf

Proportionality

- 5.18 The OFT guidance identifies three criteria as relevant to whether adverse effects on competition are significant, and thus whether a reference to the CC may be appropriate.
- 5.19 First, the OFT appreciates that a reference to the CC may impose a burden on the business concerned and, in addition, requires a significant resource commitment by the CC itself. We also recognise, however, that the market for local bus services is large. Some £3.6 billion is received in revenue by the industry every year with £1.2 billion, a third, coming from the public purse. It follows that a relatively small reduction in any adverse effects which the CC may find would offset the costs of the reference.
- 5.20 Second, a significant proportion of the market is affected by the features that we suspect prevent, restrict or distort competition: the features identified generally apply across a large proportion of many local markets.
- 5.21 Third, the features identified as adversely affecting competition are unlikely to be short lived: the current market structure in terms of geographic location, market concentration and the identities of the major players has not changed significantly in the last ten years. In addition, many of the problems in supported services have existed for at least five years and in some cases longer.
- 5.22 The OFT also considers whether there are any offsetting benefits of the identified features to consumers. In this case, we do not consider that there are any such offsetting benefits.
- 5.23 The major bus operators and several other respondents have expressed the view that a reference to the CC is a disproportionate way to address the problems that the OFT has identified. In particular they point to the variety of other mechanisms that exist for addressing the issues at hand.

- 5.24 First and foremost, respondents pointed to the role of the LTA 2008 which, they argued, had been specifically designed to address the sort of market difficulties that the OFT identified. It was put to us that the LTA 2008 powers were starting to be implemented hence this was an inappropriate time to be making a decision on reference as the market was in flux – a number of examples of proposals being drawn up under the LTA 2008 were highlighted by respondents. It was also put to us that the uncertainty created by a reference to the CC may delay or deter use of powers under the LTA 2008.
- 5.25 We note that the LTA 2008 does not directly address concerns relating to exclusionary behaviour nor can it address fundamental structural issues such as ownership of/access to depots. The concerns raised in the Proposed Decision and this Decision are wide ranging and include issues that may limit the effectiveness of the Act. For example, the regional concentration of ownership and access to depots may be expected to impact on the degree of competition for any Quality Contract Schemes brought forward by Local Transport Authorities. We observe that a number of the LTA 2008 schemes highlighted to us, are being brought forward in conjunction with PTEs. Most of the PTEs have supported the proposed decision to make a reference to the CC (and none have opposed it), as have a number of other Local Authority respondents. We also note that the LTA 2008 does not apply to Scotland.
- 5.26 Our attention was also drawn to a number of industry consultations and initiatives as well as existing regulatory powers which, respondents claimed, addressed other issues raised by the OFT. At this stage the OFT considers that it has, on the evidence, reasonable grounds to suspect that features in local bus markets may prevent, restrict or distort competition in local bus markets. The OFT has not undertaken the necessary work to establish whether adverse effects on competition do indeed exist or what the most appropriate remedies may be. The CC is best placed to undertake this task due to its greater resources, its stronger legal powers to require information and its more formal evidence gathering procedures. It would be premature for the OFT to

issue firm recommendations or advice to government on the basis of the evidence we currently possess. Moreover, engagement in ongoing consultations would not address all the features we have identified.

- 5.27 With respect to our concerns about the tendering practices of some LTAs one respondent observed that the DfT had already commissioned the consultants PWC to consider whether tendering needed to be enhanced and, in any event, the OFT could produce its own best practice guidelines for the industry. Again, we would observe that either the OFT or CC could produce best practice guidelines but that for the OFT to do so would require significant further investigation, such as would be expected to be part of a consideration of the issues as part of an MIR. We would also observe that the area where a CC investigation may add value over and above that of the PWC review would be in the area of remedies, where the CC has substantially greater powers than the OFT. Indeed, in this respect the PWC review and a CC investigation may be complementary.
- 5.28 With respect to over-bussing and exclusionary behaviour respondents have noted that the Traffic Commissioners already have powers to deal with over-bussing issues, which they have in some instances used, and that with respect to predation, the OFT can continue to use its powers under the Competition Act. Our view is that an assessment of whether conduct infringes the Competition Act can only be made after a detailed investigation. Our view is that, given the costs of predation enquiries and the size of the markets that are affected, one possible option is for a competition authority to draw up a pragmatic set of protocols that could be deployed by Traffic Commissioners or LTAs quickly, flexibly and in the light of their understanding of local markets and the CC may be best placed to produce such guidance. We would also note however that because the conduct is best characterised as non-collusive parallelism and also because over-bussing may in many circumstances not infringe Chapter II or Article 102 TFEU we consider that a more efficient approach is to refer local bus markets to the CC and allow them to consider whether an overall remedy is available, which may or may not include using the existing powers of the Traffic Commissioners.

- 5.29 Some respondents pointed to the DfT's current consultation on smart and integrated ticketing schemes and urged us to engage with this process rather than refer the matter to the CC. It is our view that the most valuable contribution that can be made by either the OFT or the CC to this issue is further research, which we consider would be best taken forward by the Competition Commission. In this respect, we note that those respondents urging the OFT to engage with government as an alternative to making a reference to the CC, were, in the main, also of the view that the evidence collected as part of the market study was unpersuasive.
- 5.30 There are a number of additional reasons why we think that the CC might be better placed than the OFT to undertake some of the work set out here. The CC is specifically designed for this kind of second-phase review work: it has resources dedicated to this work, it has specific powers for data gathering and, should it discover that interventionist measures are required to address any of the issues then it has powers to implement such measures.

Availability of remedies

- 5.31 In accordance with our MIR Guidelines⁸¹ where the OFT has not investigated a market in sufficient depth to be confident that it can identify effective remedies it will not give this factor much weight. In light of the study's findings we consider that this applies in this instance.
- 5.32 Nevertheless, it is our view that there are efficient and proportionate potential remedies available to address the competition concerns we have outlined. We consider that those remedies may likely to include one or more of:

⁸¹ Paragraph 2.30, *ibid.*

- Tighter controls on 'over-bussing' to prevent this being used to exclude rivals without providing long term benefits to bus users. In our view, this would be most efficiently and proportionately administered by the Traffic Commissioners or LTAs.
- Encourage the use of QPS and VPAs.
- Encourage the use of QCSs to develop competition for the market rather than in the market.
- Development of a depot access regime to support the use of the new regulatory regime introduced by the Local Transport Act 2008.
- Depot divestments or divestments of other assets.
- A better exchange of best practice between LTAs with respect to supported services: some LTAs do not appear to have severe competition problems with respect to tendered services.
- Mandatory multi-ticketing arrangements to prevent large incumbents from refusing to work with smaller operators.
- National benchmarking on PQRS (price, quality, reliability, service) and profitability to make it easier for LTAs to identify where they have local commercial service provision that falls below that provided by operators in other similar areas – this would support the new regulatory regime introduced in the Local Transport Act 2008.

5.33 It is the CC's role, if it finds that there are adverse effects on competition, to undertake the detailed analysis of the causes and devise potential remedies taking into account any interactions between them, which would require further detailed consultation. It is possible that some of what may be required would involve CC order-making powers to impose remedies or at least to orchestrate their implementation.

5.34 The OFT also takes into account whether a CC investigation and report would be more appropriate because the CC has more resources, stronger information gathering powers or more formal evidence gathering

procedures.⁸² We consider that this applies in this instance. In particular, at this point in time we consider that the CC is better placed than the OFT to devote the significant resources required to conduct the remaining detailed analysis.

Alternative powers

- 5.35 The OFT has considered whether it would be more appropriate for the OFT to use alternative powers to deal with certain features of the market identified above. None of the evidence suggests the possibility of using powers available to the OFT to deal with the features identified in an efficient manner.
- 5.36 First, there is no indication that any individual agreement meets the threshold for enforcement of competition law, specifically Article 81 of the EC Treaty or of Chapter I of the CA98 so as to justify enforcement action.
- 5.37 Second, although we have received frequent allegations of targeted competition specifically designed to eliminate rivals, in particular the practice of over-bussing, we do not believe that the most efficient course of action is enforcement under Article 102 of the Treaty on the Functioning of the European Union (TFEU) or Chapter II of the CA98, which would require investigation of many individual complaints. Rather, because the conduct may be characterised as non-collusive parallelism and also because over-bussing may in many circumstances not infringe Chapter II or Article 102 we consider that a more efficient approach is to refer local bus markets to the CC and allow them to consider whether an overall remedy is available.
- 5.38 In our MIR Guidelines⁸³ the OFT sets out that we will consider a reference to the CC in circumstances where we have reasonable grounds

⁸² Paragraph 2.31, *ibid.*

⁸³ Paragraph 2.3, *ibid.*

to suspect that there are market features that prevent restrict or distort competition but not to establish a breach of the CA98. We consider that is the case here.

Undertakings in lieu of a reference

5.39 The OFT must also take account of possible undertakings in lieu of a reference that could be offered by the local bus services industry to address the concerns raised without the need for a market investigation reference. Given the interrelationship between the features of the market that we have identified, the very large number of operators in the market, the asymmetries in size between them and the fact that some of our concerns around conduct relate to some operators more than others, and the data limitations we have faced, we consider it is unlikely that we would be able to judge with any certainty whether particular undertakings will achieve as comprehensive a solution as is reasonable and practicable to any adverse effects arising from the features we have identified.⁸⁴ No undertakings in lieu of a reference have been offered during the consultation period.

Conclusions on the case for a reference

5.40 We believe that the statutory test in section 131 EA02 for making a reference is met and that having taken account of the relevant factors set out in the OFT's guidance document on market investigation references, and having carefully considered the responses to the consultation on our proposed decision, on balance, the evidence points in favour of exercising our discretion to make a reference to the CC of the supply of local bus services in the UK excluding NI and London.

5.41 We do not consider that bus services in either London or Northern Ireland should be referred because the very different regulatory regimes in those places have produced different conditions of competition.

⁸⁴ Paragraph 2.21, *ibid*

Having looked at the situation in both Northern Ireland and London we are satisfied that they are not characterised by the sorts of concerns we have with local bus services in other parts of the UK. We have therefore excluded services in Northern Ireland and London from the scope of the reference.

A TERMS OF REFERENCE

TERMS OF REFERENCE

A.1 The OFT, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), hereby makes a reference to the Competition Commission for an investigation into the supply of local bus services.

A.2 In accordance with section 133(2) and (3)(a) of the Act the Competition Commission shall confine its investigation to the effects of features of such market or markets for local bus services as exist in connection with the supply of such services in United Kingdom excluding Northern Ireland and London.⁸⁵

A.3 The OFT has reasonable grounds for suspecting that a feature or a combination of features of the market or markets for the supply of local bus services in the UK excluding Northern Ireland and London prevents, restricts or distorts competition.

A.4 For the purposes of this reference:

'local bus services' means all bus services, both commercial⁸⁶ and tendered,⁸⁷ which fall within the definition of a local service in section 2 of the Transport Act 1985.

⁸⁵ Defined by s.137 Transport Act 1985 as the administrative area of Greater London as for the time being constituted.

⁸⁶ Whether or not a grant is received in relation to any part of the service provision.

⁸⁷ Under agreements made pursuant to any of s.9A Transport Act 1968, s.63 Transport Act 1985 and s.7 Transport (Wales) Act 2006.

B CLASSIFICATION OF BUS OPERATORS

B.1 We have classified bus operators into four types: national groups, smaller groups, major independents (in which we include municipal operators) and smaller independents. The constituents of the first three categories are listed here any operator not listed is considered a 'smaller independent'.

National Groups

First Group

Stagecoach Group

Arriva

Go-Ahead Group

Smaller Groups

Centrebus

ComfortDelGro

East Yorkshire Motor Services Group

National Express Group

Rotala

Transdev

Veolia

Wellglade

Major independents and municipal operators

A Bus

Aintree Coachlines

Andybus

Anglian

AST

Avon Buses

Bakerbus

Bebb Travel

Beestons

Bennetts

Bluebird

Blue Bus of North Lanarkshire

Bodmans

Brylaine

Cardiff Bus

Carousel

Cedar Coaches

Cedric

Central Buses

Chalkwell

Chambers

Claribels

Coastal

Compass Bus

Countryliner

Courtney

D & G – Choice

Delaine

DRM

Edwardes Coaches

Emsworth & District

Ensignbus

Felix

Geldards

George Edwardes and Son

GHA Coaches

Glasgow City Bus

Go Whippet

Green Bus Service

Halifax Joint Committee

Halton Transport

Ham's Travel

Hedingham Omnibuses

Hopley's Coaches

Hornsby Travel

Hulleys

Ipswich Buses

Jim Stones

Islwyn Borough Transport (recently acquired by Stagecoach Group plc)

JPT

Kime's

Konectbus

Leven Valley

Lloyds Coaches

Lothian Buses

Marshalls

McKindless

Metro Coastlines (Blackpool)

Midland Rider

Minsterley Motors

Munro's of Jedburgh

Network Warrington

Newport Transport

NIBS

Norfolk Green

Nottingham City Transport

NTC

Nu-Venture

Olympus

Pennine

Plymouth Citybus (recently acquired by Go-Ahead Group plc)

Quantock Motors

Reading Buses

Red Rose

Regal Bus

Reliance

Renown Travel

Richardsons Travel

Ross Travel

Rossendale

Safeguard

Sanders

Sargeants

Shamrock Buses

Simonds

Somerbus

South Lancs Travel

Southdown PSV

Speedwell

Stansted Bus

Stephensons of Essex

Supertravel

Tanat Valley Coaches

T M Travel

Thames Travel

Thamesdown

Thornes / Independent

Townlynx

Travel de Courcey

Trustybus

Tyrer bus

Uno

Velvet

Wardle

Weardale

Weavaway

West Coast Motors

West End Travel

Western Greyhound

White Bus

Yeomans

C METHODOLOGY

C.1 In the light of the issues identified above at paragraph 2.5, the OFT wished to examine more closely the role played by competition in local bus services. Moreover, we wanted to explore whether weak competition, if indeed that was the case, had any material impact on bus users.

C.2 We considered both qualitative and quantitative data during our study although we have attached no particular weight to one type of evidence over another. Rather we have looked for trends and explanations of bus operators' behaviour that are well supported by a variety of independent data sources. In doing so we have considered evidence from a portfolio of research including:

- an interview programme with the major bus operators which was supported by extensive written submissions from those operators
- a public consultation which received information from a wide range of stakeholders including passengers, passenger bodies, foreign bus operators, a trade union, and a charity.
- interviews with the two main industry trade bodies
- a statistical analysis of the relationship between fares and competition
- interviews with the Passenger Transport Executives and a sample of rural LTAs, supported with data about trends in the tendering and re-tendering of procured services
- a review of complaints received by the OFT relating to competition abuses in the bus industry
- a review of the effects of mergers cleared by the OFT in the last five years.

Interviews with major operators and trade bodies

- C.3 We spoke to each of the five largest bus operators outside of London: First Group plc, Stagecoach Group plc, Arriva plc, Go-Ahead Group plc, and National Express Group plc. In addition to this we surveyed these same operators with a detailed questionnaire which was designed to identify differences between different operating companies within each of the groups so that those companies could be compared and contrasted.
- C.4 We also met with the two main trade bodies, the Confederation for Passenger Transport and Association of Local Bus Managers who between them represented the several hundred bus operators that it was not possible to interview.

Public consultation

- C.5 The public consultation produced a wide variety of responses with varying degrees of relevance to the terms of reference of the study. We received some particularly thoughtful, well evidenced and directly relevant submissions from bus operators we had not interviewed, including both UK based and foreign based operators. We also received a number of submissions, some written, others provided in meetings, from bodies representing bus users and workers in the transport industry. While useful, much of this information was contextual rather than directly relevant to the terms of the study.

Statistical analysis

- C.6 We were keen to use the study to move beyond anecdotal evidence about the bus industry and to attempt a more systematic analysis of some of the key questions. In pursuit of this objective the five largest bus operators agreed to waive their confidentiality so that we could obtain from the DfT a detailed dataset of revenues, passenger numbers and vehicle kilometres for their various operating companies. We applied a number of statistical techniques to this data to examine whether market concentration had any effect on the fares bus users pay and the

investment bus companies make. We supported this work by commissioning the Institute of Transport at the University of Leeds to prepare for us route based maps of the operating areas of some of the larger players.

Interviews of LTAs

- C.7 We spoke to all seven PTEs and a small sample of LTAs about their experiences procuring supported bus services. These bodies were able to provide us with data regarding the bids for, and outcome of, these tenders. We were then able to examine this data to look for evidence of collusion and to establish the rate at which tenders were won by non-incumbent bidders.

Review of complaints

- C.8 We reviewed our complaints of predatory or exclusionary behaviour that we had received since the introduction of the Competition Act 1998 came into force in 2000 to assess whether there were any significant trends in this data.

Applicability of findings to many markets

- C.9 There are many local bus markets comprising both commercial services and supported services. We have conducted our analysis in a manner which gives us confidence that our findings are sufficiently representative that they can be said to apply to most, if not all, local bus markets.
- C.10 In particular, we have used large samples, to gain a representative picture. We received questionnaire responses from each of the five largest operators, which provided detailed information about their operations at a subsidiary level. These five operators have subsidiaries that, between them, are active in every region of the UK excluding NI and London and in many local markets.

- C.11 We also examined a large sample of tendered routes. By obtaining data from the 7 PTEs as well as four other LTAs, we were, in effect, considering more than 50 per cent of the tendered routes in the UK.
- C.12 This analysis was supplemented by additional data obtained from bodies with a national perspective: ATCO, CPT and ALBUM. These bodies were able to give us an overall view of local bus markets in general. We are therefore confident that our analysis has captured the variety across local bus markets.

D LEGAL FRAMEWORK

- D.1 The current legal framework within which local bus services are operated in England and Wales (outside Greater London) is set out in the Transport Act 1985 (the TA 1985). In brief, the effect of the provisions contained in that Act was to deregulate the bus market in the UK outside Northern Ireland and London.⁸⁸
- D.2 The powers of LTAs were enhanced under the Transport Act 2000 (TA 2000). The TA 2000 introduced Quality Partnership Schemes (QPSs) and Quality Contract Schemes (QCSs) which are instruments allowing LTAs to require bus operators to meet certain quality standards (see paragraphs D.4 to D.10). The TA 2000 also empowers LTAs to set up ticketing schemes, whereby operators of local bus services are required to make and implement arrangements to accept each other's tickets or provide integrated ticketing in ways specified in the scheme. More recently the Local Transport Act 2008 (LTA 2008) has made further amendments in particular in relation to QPSs and QCSs. It has also introduced new provisions about Voluntary Partnership Agreements (VPAs) and other qualifying agreements.⁸⁹
- D.3 In March 2009, the DfT and the OFT published joint guidance on the application of competition law to certain aspects of the bus market following the LTA 2008 (the Guidance).⁹⁰ As explained in its introduction, the Guidance is primarily intended to assist LTAs and bus operators which are entering into, or are participating in, a QPS or other bus partnership agreement, to assess whether the arrangements to

⁸⁸ The Scottish Bus Group was restructured by the Transport (Scotland) Act 1989 before being privatised.

⁸⁹ Many voluntary partnership agreements were already in existence prior to LTA2008. Amendments to the 2000 Act made by the 2008 Act introduce a statutory definition of a voluntary partnership agreement.

⁹⁰ www.offt.gov.uk/shared_offt/business_leaflets/general/offt452.pdf

which they are a party (or are entering into) comply with competition law. The guidance also considers how competition law applies to certain aspects of the LTAs' functions in the making and varying of ticketing schemes and the inviting and accepting of tenders.⁹¹

Quality Partnerships Schemes (QPS)

- D.4 QPSs are statutory schemes introduced under the TA 2000, under which an LTA, or two or more LTAs jointly, agree to invest in improved facilities at specific locations along bus routes.⁹² Such facilities might include bus stops, bus lanes and other bus priority measures or enhanced facilities for passengers at bus stops and bus stations. Operators of local services who wish to use such facilities must undertake to provide services of a particular standard such as running new vehicles or increasing the standard of driver training.
- D.5 Only those operators prepared to provide services to the standards specified in the scheme are permitted to use the facilities. Other operators are not generally prevented from providing local services in the area covered by the scheme, but they cannot use the facilities provided by the LTA under it. QPSs give enforcement powers to the Traffic Commissioners against an operator that uses the facilities without complying with the requirements of the scheme.

⁹¹ There exists also the block exemption from the Chapter I prohibition in the Competition Act 1998 for certain specified types of public transport ticketing arrangements: Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001 SI 2001/319 as amended by the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption)(Amendment) Order 2005 SI 2005/3347. The OFT has issued a guideline on the public transport ticketing schemes block exemption (OFT 439): www.of.gov.uk/shared_of/business_leaflets/ca98_guidelines/of439.pdf

⁹² Once the scheme is formed the LTA is under a statutory duty to provide the facilities identified in the scheme from the dates specified, and to maintain those facilities for as long as the scheme is in operation.

- D.6 QPSs are subject to a competition test,⁹³ the purpose of which is to ensure that any adverse effect on competition is outweighed by the wider benefits to users. The OFT is entitled to investigate whether the making or varying of a scheme complies with the competition test. If it finds that the competition test is not met, the LTA would not be able to proceed with the scheme in its current form and the OFT may require it to be varied or revoked.
- D.7 The LTA 2008 has introduced several changes to increase the powers of LTAs setting up a scheme:
- schemes will be able to include service frequency, timings and maximum fares as part of the standard of service to be provided under the scheme in addition to quality standards⁹⁴
 - both facilities and service standards may be phased in on predetermined dates over a period of time, rather than the current procedure under which all facilities and standards must be available when the scheme takes effect, and
 - where a scheme is in operation, a QPS may also specify restrictions on the registration of certain new local services (or variation / withdrawal of existing ones) where the LTA considers that the provision of such services may be detrimental to the provision of services under that scheme. For example, restrictions could be

⁹³ The Test applicable to QPS is set out in Part 1 of Schedule 10 to the 2000 Act. The OFT and DfT have produced new joint guidance which covers the application of competition law in more detail. Available at: www.dft.gov.uk/pgr/regional/localtransportbill/vpaguidance.pdf

⁹⁴ Previously Section 114 of TA 2000 excluded the requirements as to frequency or timing of services from the description of a 'standard of service'.

imposed on services running on a nearby parallel route where such service could undermine the viability of QPS services.⁹⁵

Quality Contract Schemes (QCS)

- D.8 A QCS is a scheme under which the LTA determines the necessary level and standards of bus provision for the area and grants a particular operator the exclusive right to operate certain services following a competitive tender. They are, in effect, exclusive franchising schemes and no other operators may function in the quality contract area.
- D.9 Under the TA 2000, the conditions for setting up a QCS were very restrictive. They could only be introduced where an LTA was satisfied that making a scheme was 'the only practicable way' of implementing the policies set out in their bus strategy in the area, and the proposed scheme would implement those policies in a way which was economic, efficient and effective. The implementation of QCSs was also made difficult by the requirement that the Secretary of State approves the scheme and by a statutory minimum waiting period of 21 months before the scheme can be implemented (this was reduced to six months in 2004).
- D.10 No QCS has ever been applied for. In order to remedy this, the Government put forward proposals to relax the QCS regime, which has led to some changes in the LTA 2008:
- The requirement that a QCS must be the 'only practicable way' of implementing the policies in the LTA's bus strategy has been removed. Under the new rules, the LTA must satisfy itself that the scheme:
 - will result in an increase in the use of bus services

⁹⁵ Where these are included, the scheme must also include registration criteria, against which the Traffic Commissioner must decide whether or not to accept applications to register new services, or to change existing ones.

- will bring benefits to persons using local services
 - will contribute to the implementation of the local transport policies in a way which is economic, efficient and effective, and
 - is proportionate.
- QCSs in England no longer need to be approved by the Secretary of State. Instead, there will be a new type of board (QCS boards) chaired by the Traffic Commissioner to provide advice and recommendations to the LTA proposing to make the scheme.
 - The maximum duration of a QCS has been extended from five years to 10 years. If on review, it is decided to continue with the QCS, a fresh scheme must be made.⁹⁶
 - different parts of a QCS can come into effect on different dates. This amends the provisions of the TA 2000 where all parts of the scheme had to come into operation on the same date.

Voluntary Partnership Agreements (VPAs)

- D.11 VPAs are voluntary agreements under which an LTA, or two or more LTAs, undertake to provide particular facilities, or do anything else for the purpose of bringing benefits to persons using local services, and one or more operators of local services undertake to provide services of a particular standard.⁹⁷
- D.12 VPAs are used as a means of improving the quality of bus services in a particular area. Unlike a QPS, which is a scheme made by an LTA, a

⁹⁶ Section 131A of the TA 2000.

⁹⁷ A VPA agreement must involve at least one LTA in order to satisfy the definition of a VPA. For example an agreement involving two or more bus operators but no LTA, cannot be a VPA.

VPA is entered jointly by LTAs and bus operators.⁹⁸ VPAs are subject to a competition test⁹⁹ which weighs any restriction on competition against the overall benefits to passengers'.

- D.13 The LTA 2008 removes the risk of financial penalties where such agreements are entered into in good faith. Under the new regime, where an agreement falls under the new competition test (requiring certification by an LTA), the power for OFT to impose financial penalties in respect of a non-compliant agreement does not apply. However, the OFT would be able to direct that a non-compliant agreement be varied (in order to make it compliant) or terminated.

Supported services

- D.14 Commercial bus operators may conclude that some existing or potential routes, in whole or in part, are not commercially viable, resulting in their withdrawing from or failing to offer services on them. When this happens, statutory obligations on LTAs (or any other body with similar responsibility) may be triggered.
- D.15 Broadly speaking, those obligations impose a duty on the relevant authorities (Passenger Transport Authorities and their Executives in metropolitan areas,¹⁰⁰ county councils and unitary authorities in non-metropolitan areas¹⁰¹) to secure the provision of such public passenger transport services as they consider necessary to meet the public transport requirements in their areas, where those requirements would

⁹⁸ Unlike a QPS, a VPA does not give any enforcement power to the Traffic Commissioner against an operator who uses the facility without providing the service to the required standard.

⁹⁹ The Test applicable to VPAs is set out in Part 2 of Schedule 10 to the 2000 Act. The OFT and DfT have produced new joint guidance which covers the application of competition law in more detail. Available at: www.dft.gov.uk/pgr/regional/localtransportbill/vpaguidance.pdf

¹⁰⁰ Section 9A Transport Act 1968 (as amended)

¹⁰¹ Section 63 Transport Act 1985 (as amended)

not be met in the absence of such action. The Welsh assembly has a similar power, though it is under no duty.¹⁰²

- D.16 Our study analysed trends in supported services/tendered contracts and we have concerns about some of what we found. Our concerns, based on the evidence that we have seen, are not, however, related to the effects on competition of putting such services out to tender. It is that latter point to which the Guidance relates and so we do not consider the Guidance on that point relevant to our proposed decision.
- D.17 Similarly, we do not consider that the treatment in the Guidance of ticketing schemes is relevant to our proposed decision.¹⁰³ The Guidance deals with the possible effects on competition of such schemes and the application of competition law to them. In the market study, by contrast, we were told of a lack of commercial incentive for operators with an established local network to enter into multi-operator ticketing arrangements.

¹⁰² Section 7 Transport (Wales) Act 2006 (as amended)

¹⁰³ Nor indeed is our Guidance on the Public Transport ticketing schemes block exemption www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/oft439.pdf